

Client Alert: Exempt Organizations Engaged in Illegal Activities – Will They Be Held Accountable?

9 Mar 2021

In the aftermath of the January 6, 2021 insurrection, the focus has shifted to the entities that may have financed the insurrection. Thousands of individuals travelled to Washington, D.C. for the rally and insurrection, and news reports have alleged that charitable organizations may have assisted in funding the participants' expenses. On January 13, 2021, members of the Ways and Means Committee in the House of Representatives sent a [letter](#) to then Treasury Secretary Stephen Mnuchin encouraging Treasury to update guidance warning tax-exempt organizations of the consequences of engaging in illegal activity. In the letter, the Ways and Means Committee members state the following: "We are outraged by recent reports alleging that tax-exempt organizations may have incited and facilitated this act of insurrection that gravely endangered the security of the United States and its institutions of government... We must ensure that tax-free dollars are never used to plan or sponsor illegal activities aimed at undermining the Constitution, the rule of law, and our American democracy." In a follow-up [letter](#) on March 5, 2021, the Chairman of the Ways and Means Committee on Oversight wrote to Treasury Secretary Janet Yellen imploring her to ensure that exempt organizations are not participating in illegal activities.

The Internal Revenue Code ("IRC") prohibits exempt organizations from engaging in actions classified as terrorism. IRC §501(p) was enacted as part of the Military Family Tax Relief Act of 2003 and provides that the tax-exempt status of a designated terrorist organization will be suspended during the period of time the organization is classified as a terrorist organization under §212(a)(3)(B)(vi)(II) or §219 of the Immigration and Nationality Act. However, section 501(p) does not allow the suspended organization to judicially challenge the designation. Thus, the courts have not interpreted this statutory provision. Similarly, there are no Treasury Regulations interpreting §501(p).

For other types of illegal activity, a judicially created "public policy doctrine" has been developed. The public policy doctrine has been used to justify revocation of exempt status for organizations engaging in other actions, such as race-based discrimination. In *Bob Jones University v. United States*, 461 U.S. 574 (1983) the Supreme Court revoked the tax-exempt status of the private school due to its racially discriminatory policies. Additionally, the 4th Circuit Court of Appeals discussed the limits of a charity's activities and denied exempt status based upon public policy grounds. In *Nationalist Movement v. Commissioner*, 37 F.3d 216 (5th Cir. 1994), the Court found that the organization's promotion of its "pro-majority" agenda favoring "American nationality" was not consistent with charitable status and the organization was denied tax-exempt status under IRC §501(c)(3).

Secretary Yellin and the Department of Treasury have tools to assist in ensuring that tax-free dollars are never used to plan or sponsor illegal activities, such as domestic terrorism. However, the law could be strengthened with new Treasury Regulations and/or a Treasury Notice alerting the public of the dangers and consequences of funding domestic terrorist organizations and activities, along with the limitations imposed by the public policy doctrine. Many laws and much guidance were issued in the aftermath of the September 11, 2001 terrorist attacks, but much of that guidance is focused on foreign terrorist organizations. The laws and guidance need to be updated and expanded to clearly include acts of domestic terrorism and to sanction U.S. entities, including charities.

The current §501(p) prohibition against tax-exempt status for a terrorist organization is dependent upon designation by a separate government agency, which does not expressly allow retroactive enforcement for acts prior to said designation.

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Treasury should clarify that public policy considerations prohibit organizations from engaging in an insurrection against the United States government and other related activities, without waiting for classification of an offending charity under the Immigration and Nationality Act. Treasury and the IRS should clarify that public policy prohibits the use of funds for such illegal activities, and assert its authority to impose sanctions, penalties, and/or revocation. There are criminal and civil penalties available to enforce the prohibition of charitable funding of illegal activities through 18 USC §2339C. Criminal liability and/or civil penalties of at least \$10,000 are available for government enforcement actions. Treasury should emphasize its willingness to engage the Department of Justice to prosecute U.S. charities in appropriate circumstances. Treasury could also publish Regulations that allow the Internal Revenue Service to retroactively revoke an organization's exempt status for the support of terroristic activities, rather than merely a suspension of charitable status during the period of time the organization is designated as a terrorist organization.

Illegal activities should never be financed by organizations that are eligible to receive charitable donations. Charitable funds must be limited to furthering legitimate charitable activities. Treasury has the unique opportunity to take a position on the topic and strengthen enforcement of both the public policy doctrine, §501(p), and the more serious criminal and civil penalties. Treasury should indicate its willingness to pursue criminal and civil liability against any charitable organization abusing exempt status by engaging in illegal activities, including domestic terrorism. Congress should fund increased enforcement actions by the IRS to allow greater oversight of exempt organizations so that charities are not emboldened to engage in illegal actions. Charities funding terrorism of any kind need to be held accountable for their actions. In this manner, law-abiding charities and concerned donors can be secure in knowing their dollars are being used for legitimate charitable activities and purposes.

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TAGGED: irs, tax exempt organizations, Tax Law, Internal Revenue Code, January 6 Insurrection, Military Family Relief Act, Bob Jones University v. United States, Nationalist Movement v. Commissioner