Explainer

IRS Investigations of Nonprofits

August 2026

ICNL
INTERNATIONAL CENTER
FOR NOT-FOR-PROFIT LAW

ICNL

www.icnl.org
info@icnl.org

EXPLAINER

IRS Investigations of Nonprofits

Table of Contents

INTERNATIONAL CENTER
FOR NOT-FOR-PROFIT LAW

1660 L Street NW, Suite 600
Washington, DC 20036

ICNL INTERNATIONAL CENTER FOR NOT-FOR-PROFIT LAW

EXPLAINER

IRS Investigations of Nonprofits

This explainer was produced for informational purposes only and does not constitute legal advice or substitute for legal counsel.

Members of Congress have recently urged the IRS to investigate nonprofits for alleged violations of the Internal Revenue Code (IRC) and other federal laws. The FBI and the IRS have also reportedly launched a joint initiative to investigate nonprofits suspected of funding or supporting domestic terrorism.

The IRS has a legitimate interest in ensuring that nonprofits are complying with requirements to maintain tax-exempt status. However, lawmakers and nonprofit leaders have raised concerns about the potential for the IRS to engage in politicized investigations of nonprofits. If the IRS misuses its investigatory powers when scrutinizing nonprofits, it can undermine organizations' ability to pursue their missions, infringe on constitutionally protected rights, and open the door to politicized scrutiny of other taxpayers.

To help nonprofits understand and prepare for potential IRS investigations, this explainer describes three tools that the IRS may use to investigate nonprofits: (1) voluntary compliance checks, (2) audits, and (3) criminal tax investigations. For each investigatory tool, the explainer covers what may trigger its use, how the IRS uses it, and legal and institutional protections for nonprofits. The explainer ends by offering practical steps nonprofits can take to prepare for and respond to scrutiny.

While the IRS may use these tools to investigate any tax-exempt organization, as well as individuals and for-profit entities, this explainer focuses on the tools in relationship to 501(c)(3) nonprofits.

Summary

Compliance checks: The IRS uses voluntary compliance checks to ensure that a nonprofit is complying with recordkeeping and information reporting requirements, and that its activities are consistent with its stated tax-exempt status. During a compliance check, the IRS reviews forms that a nonprofit has submitted, such as the Form 990 series. The IRS may decide to audit a nonprofit if it identifies concerns during a compliance check.

Audits: During an audit (or "examination") the IRS may examine a nonprofit's books and records and question its officers and staff to determine if the forms it has filed are accurate and if the nonprofit continues to qualify for tax-exempt status. Conduct that may lead to an audit includes if a 501(c)(3) nonprofit engages in activities that are inconsistent with its exempt purpose, impermissibly further a private benefit, constitute electioneering, or violate proscribed limits on lobbying. If an audit results in an adverse determination, the IRS can take several actions, including potentially revoking a nonprofit's tax-exempt status or reclassifying a nonprofit from a public charity to a private foundation.

Criminal investigations: The IRS is the sole federal agency authorized to investigate alleged crimes under the Internal Revenue Code. It may also investigate other crimes designated by the Treasury Secretary. Conduct that may lead to a criminal investigation includes making false statements to the IRS or obstructing an IRS investigation. During a criminal investigation, the IRS or law enforcement can gather information through various methods, including issuing an administrative summons, engaging in surveillance, or obtaining a subpoena or search warrant. As a result of a criminal investigation, the IRS may recommend that the Department of Justice (DOJ) pursue prosecution of a nonprofit.

While IRS audits and criminal investigations of nonprofits are relatively rare, responding to them can divert an organization's resources from its mission. They can also affect an organization's reputation and undermine its relationships with donors and partners. In extreme cases, they can lead to legal consequences, such as revocation of an organization's tax-exempt status, fines, or imprisonment for an organization's officers or staff. More information is provided below.

Compliance checks

A compliance check is the IRS's least intrusive form of investigating a nonprofit (See 26 USC §7601). The Exempt Organizations (EO) unit of the IRS's Tax Exempt and Government Entities (TE/GE) Operating Division undertakes compliance checks to ensure that (1) a nonprofit is complying with its recordkeeping and information reporting requirements and (2) its activities are consistent with its stated tax-exempt purpose.

During a compliance check, the IRS reviews forms that a nonprofit has submitted to the IRS, such as the Form 990 series, W-2, or 1099. The IRS will typically engage with a nonprofit's staff through a phone call or in-person interview, or send a questionnaire electronically or by mail. During a compliance check, unlike in an audit, the IRS does not actively inspect a nonprofit's books or records (IRM 4.70.10.2).

Compliance checks are voluntary and do not result in penalties if a nonprofit refuses to participate. On the other hand, the IRS may open an audit of a nonprofit if it identifies concerns during a compliance check. To notify an organization that it has concluded a compliance check, the IRS generally issues a closing letter.

The IRS may subject an organization to more than one compliance check in a tax year "if facts and circumstances warrant." However, there are internal safeguards against potential IRS abuse of the compliance check. According to the Internal Revenue Manual (IRM)—the IRS's nonbinding internal operating procedures—two internal IRS review groups are responsible for ensuring that compliance checks are conducted in line with "technical, procedural and administrative requirements" (IRM 4.70.10.1.5). Organizations that feel the IRS may have treated them unfairly during a compliance check may also be able to seek protections, discussed in more detail below (see "What protections do nonprofits have during IRS investigations?").

Audits (Examinations)

WHAT IS AN AUDIT?

The IRS may audit a nonprofit to determine if the forms it has filed are accurate and if the nonprofit continues to qualify for tax-exempt status (See 26 USC §7602). During an audit, the IRS reviews a nonprofit's books and records and may question its officers and staff. It also has broad authority to issue summonses for documents or witness testimony from third parties connected with the subject of the audit, such as a nonprofit's bank. The IRS enforces a summons through a federal district court. The IRS must notify the subject of the audit of its intention to contact third parties during an audit before doing so, with some exceptions.

An audit typically begins with initial contact—either through a letter or phone call—to explain the scope and process of the audit, including providing an initial information document request to the organization. The IRS then uses different auditing techniques depending on the nature and complexity of the case. These include:

- **Correspondence examination:** The IRS conducts the audit by mail, requesting specific documents or information in writing.

- **Office examination:** The nonprofit's representatives meet with IRS auditors at an IRS office.

- **Field examination:** IRS auditors visit the nonprofit to conduct the examination on-site. The IRS sometimes uses a team of specialists rather than a single agent to conduct field examinations when there are larger, more complex nonprofits or cases.

HOW DOES THE IRS DECIDE WHICH NONPROFITS TO AUDIT?

The IRS may decide to audit a nonprofit after identifying or receiving information about potential noncompliance. The IRS may acquire such information through means including:

- **Data-driven analysis**: The IRS uses a data-driven approach to identify potential red flags in nonprofits' filings, including the Form 990 series.
- **Complaints and referrals**: The IRS may initiate an audit after receiving third-party complaints about a nonprofit's noncompliance or referrals from other government agencies. The IRS maintains a Whistleblower Program which offers awards for people who provide information about noncompliance with laws that the IRS administers, enforces, or investigates.
- **Media reports:** The IRS may audit a nonprofit after reviewing media reports indicating that the organization may not be complying with relevant law.
- **Compliance checks**: The IRS may initiate an audit after discovering evidence of a potential violation during a compliance check.

The IRS regularly issues "compliance strategies" that articulate issue areas that it prioritizes for audits and its other compliance actions.

Examples of issues that may lead to an audit of a 501(c)(3) nonprofit include:

- **Private benefit or inurement:** A 501(c)(3) nonprofit cannot be organized or operated to benefit private interests or inappropriately benefit those who control the organization. Examples of violations include:

  - **Excess executive compensation or other benefits:** A 501(c)(3) nonprofit cannot provide excessive executive compensation or other excessive benefits to those with substantial influence over the organization (26 USC 4598). A nonprofit can show that compensation it provides to certain persons is presumptively reasonable by meeting three requirements outlined by the IRS.

  - **Personal use of organizational assets:** Directors or staff members of a nonprofit cannot use the nonprofit's assets for personal use. For example, it may be a violation for a staff member to use a nonprofit's car for personal transportation without compensating the organization.

  - **Business transactions that disproportionately benefit someone connected to the nonprofit:** An example of private inurement could include if a nonprofit has a contract with a member of its board that compensates the member in excess of the service provided.

- **Engaging in activities inconsistent with a nonprofit's exempt purpose or furthering a nonexempt purpose:** A 501(c)(3) organization must pursue exempt purposes, such as a charitable, religious, or educational purpose. Examples of violations might include:
  - **Having a high proportion of income from unrelated business activities:** The IRS may question whether a 501(c)(3) organization operates exclusively for its stated exempt purpose if it reports a high proportion of income from unrelated business income (UBI).
  - **Engaging in unlawful activities**: A 501(c)(3) organization can lose its tax-exempt status if its purpose is illegal or it is engaged in substantial illegal activities.
  - **Engaging in activity contrary to public policy**: 501(c)(3) organizations may not engage in activity that is "contrary to fundamental public policy" (Bob Jones University v. United States, 461 U.S. 574 (1983)). The IRS has historically almost exclusively invoked this justification for revocation of tax-exempt status in the context of racial discrimination in educational institutions.
- **Engaging in prohibited political or lobbying activities:** A 501(c)(3) organization cannot engage in electioneering and must comply with proscribed limits on lobbying activities.
- **Failure to pay required taxes**: For example, exempt organizations with employees must pay employment taxes.
- **Misclassification of an organization as a private foundation or public charity**: 501(c)(3) organizations are subject to different rules based on their classification as either a private foundation or public charity. A public charity receives support from the general public or government sources and must meet a public support test unless it is a church, school, hospital, or other category deemed to inherently be a public charity. By contrast, a private foundation is typically supported by a single or small number of sources. Unlike a public charity, it must pay an excise tax on net investment income and comply with certain operational requirements.

- **Foreign grantmaking for non-charitable purposes:** In recent years, the IRS has scrutinized 501(c)(3) organizations making foreign grants to ensure that that the funds are being used for their stated charitable purposes.

- **Failure to file a Form 990 series return or other required returns**: Exempt organizations must file the Form 990 and relevant accompanying forms (called "schedules") annually, with some exceptions. If an exempt organization fails to file a Form 990 or 990-N for three years in a row, its exempt status is automatically revoked. This is statistically the most common reason for revocation.

WHAT CONSEQUENCES MIGHT ARISE FROM AN AUDIT?

The IRS's Tax Exempt and Government Entities Operating Division may take several actions after auditing a nonprofit if it finds the nonprofit has not met its legal requirements:

- **Revocation**: Revoke the organization's tax-exempt status if an organization has failed to follow legal requirements to maintain its 501(c)(3) status.

- **Reclassification:** Reclassify the nonprofit from a public charity to a private foundation. This does not revoke the nonprofit's tax-exempt status, but private foundations must pay an annual tax on net investment income, comply with additional operational requirements, and have different reporting requirements.

- **Other actions:** TE/GE could also impose an employment tax, tax on unrelated business income, or excise tax (as relevant), and impose interest and penalties on underpayments on certain taxes. It may also choose to provide an advisory to the nonprofit related to compliance and then check on the nonprofit's implementation of the advice later.

HOW CAN A NONPROFIT APPEAL AN ADVERSE DECISION REGARDING ITS STATUS?

During an audit, TE/GE may share a "proposed adverse determination letter" with a nonprofit if it finds that the organization has not met the requirements for the section under which it is claiming tax-exempt status. A proposed adverse determination letter lays out the proposed action (such as a revocation of an organization's tax-exempt status), the facts upon which TE/GE based the proposed action, applicable law and precedents, TE/GE's reasoning for the proposed action, and steps to appeal the decision, among other information. If the nonprofit does not appeal the proposed adverse determination within a set time or its appeal fails, the IRS will issue a "final adverse determination letter."

Requesting a conference with a manager. A nonprofit may request a conference with the manager of the IRS employee who issued a proposed adverse determination letter during an audit. If a nonprofit does not agree with the proposed adverse determination after speaking with the manager, it can appeal the determination.

Challenging a proposed adverse determination letter before the Appeals Office. The Appeals Office is the dispute resolution forum of the IRS and makes a resolution process for federal tax controversies "generally available to all taxpayers" (See IRC 7803(e)(4), 26 CFR § 301.7803-2 and 26 CFR § 301.7803-3). To challenge a proposed adverse determination letter before the Appeals Office, a nonprofit must submit a written protest in the time and manner prescribed in the letter (see 26 CFR § 301.7803-2(e)), which is generally within 30 days of receipt (IRS Rev. Proc. 2018-5, Section 9.04). If the organization submits a timely protest, TE/GE will review the protest and either issue a favorable letter or forward the case to Appeals Office. The Appeals Office will consider the protest and issue a final determination letter (IRS Rev. Proc. 2018-5, Sections 9.06-9.07). The Appeals Office must provide written notice to a taxpayer if it denies an appeal request, with limited exceptions (26 CFR § 301.7803-3(a)).

Referring an issue to the Office of the Associate Chief Counsel ("Chief Counsel"): At any time during an audit or an appeal of a determination arising from an audit, an organization may request that an issue be referred to the Chief Counsel for advice or guidance if it believes that the issue is not covered by precedent or that the IRS is treating the issue inconsistently.

Petitioning a final adverse determination letter to a federal court. An organization may petition certain final adverse determinations by the IRS to the U.S. Tax Court, the U.S. Court of Federal Claims, or the U.S. District Court for the District of Columbia for a declaratory judgment. This includes determinations of an organization's qualification for tax-exempt status and classification as a private foundation or public charity (26 USC §7428(a)(1)(E)). The organization generally has 90 days from the date of the final determination letter to file the petition. Before filing, it must have exhausted all available administrative remedies, including appealing the proposed adverse determination letter to the Appeals Office (Internal Revenue Code §7428). Alternatively, the nonprofit can petition for a declaratory judgment if the IRS has not issued a notice of final determination after 270 days have passed since the organization requested a determination of its status (26 USC§7428(b)(2)). Historically, very few nonprofits have filed for declaratory judgment cases involving revocation of tax-exempt status.

An organization may appeal a final determination directly to a federal court, bypassing the internal appeal process within the IRS, in a limited set of situations. For example, a nonprofit can challenge the underlying constitutionality of the statute at issue (26 CFT §301.7803-2(c)(18)) directly before a federal court.

Opting into Fast Track Settlement (FTS) at any time. The IRS offers an expedited alternative dispute resolution process known as FTS to tax-exempt entities. FTS aims to expedite case resolution by allowing the parties to work through disputes while an audit is in progress and outside of the formal protest system. A nonprofit can request FTS any time after an issue has been "fully developed," but before the IRS issues a proposed adverse determination letter. During FTS, an Appeals Office official serves as a neutral party to facilitate an agreement between the organization and the IRS. A nonprofit retains traditional appeal rights if any issues remain unresolved after FTS.

Criminal investigations of nonprofits

WHAT IS AN IRS CRIMINAL INVESTIGATION?

The IRS has exclusive jurisdiction among federal agencies over investigating potential criminal violations of the Internal Revenue Code. The IRS can also investigate criminal violations of other laws for which the Treasury Secretary has delegated it investigative authority (26 USC §7608). The IRS's Criminal Investigation Division (IRS-CI), which is separate from TE/GE, leads these investigations. Once IRS-CI has completed a criminal investigation, it decides whether to recommend the case for prosecution by the Justice Department. See below for more details on this process.

The FBI and other law enforcement agencies can investigate nonprofits or their officers or staff for federal crimes unrelated to the Internal Revenue Code without involving IRS-CI.

WHAT ARE GROUNDS FOR AND POTENTIAL CONSEQUENCES OF AN IRS CRIMINAL INVESTIGATION?

The IRS may initiate a criminal investigation if it suspects fraud or determines a nonprofit or its staff may be involved in a tax-related crime. The IRS may also initiate an investigation based on a referral from another law enforcement agency or information received from the public. Significantly, most—though not all—crimes that IRS-CI investigates require that a prosecutor prove that the defendant had a specific intent to commit the offense, creating a relatively high evidentiary burden for conviction.

Potential crimes that might form the basis of an IRS criminal investigation include:

- **Willfully filing false statements (IRC § 7206)** on the Form 990 series or other required documents filed with the IRS (see IRM 25.1.9.5.1(1)(a)). The potential penalty is a fine of up to $100,000 for an individual or $500,000 for a corporation, imprisonment of up to 3 years, or both, along with the costs of prosecution.

- **Knowingly and willfully making false statements to any federal official (18 USC § 1001).** Violations of this provision include making false statements to IRS agents during audits (see IRM 9.1.3.4.10). The potential penalty is a fine of up to $250,000 for an individual, imprisonment of up to 5 years, or both. If the false statement relates to a crime involving international or domestic terrorism as defined under 18 USC §2331, the potential penalty is up to 8 years' imprisonment.
- **Corruptly obstructing an IRS investigation (IRC § 7212).** This may include coaching witnesses to provide false testimony to the IRS or destroying evidence (see IRM 9.1.3.3.13). The potential penalty is a fine of up to $5,000, imprisonment of up to 3 years, or both.
- **Intentionally conspiring to defraud the United States (18 USC § 371).** This includes schemes to defraud the IRS in its assessment or collection of taxes, such as when directors of an organization agree to falsify documents submitted to the IRS to obtain tax-exempt status. The potential penalty is imprisonment of up to five years.
- **Willfully evading taxes (IRC § 7201).** The IRS considers acts such as filing a false Form 1023 or Form 990 series to be an affirmative act leading to tax evasion (see IRM 25.1.9.5.1(1)(b)). The potential penalty is a fine of up to $100,000 for an individual or $500,000 for a corporation, imprisonment of up to 5 years, or both, with the costs of prosecution.
- **Willfully failing to collect employment taxes (IRC § 7202),** such as where withheld payroll taxes are used as operating funds rather than remitted to the IRS (See IRM 9.1.3.3.3.1.2). The potential penalty is a fine of up to $10,000, imprisonment of up to 5 years, or both, with the costs of prosecution.
- **Knowingly engaging in money laundering (18 USC § 1956 and §1957).** §1956 criminalizes conducting or attempting to conduct a financial transaction knowing the funds were derived from specified unlawful activities, including fraud, with (a) intent to promote the carrying on of specified unlawful activity, (b) intent to engage in tax evasion or tax fraud, (c) knowledge that the transaction is designed to conceal or disguise the nature, location, source, ownership, or control of the proceeds of a specified unlawful activity, or (d) knowledge that the transaction was designed to avoid a transaction reporting requirement under state or federal law. The potential penalty is a fine of up to $500,000 or twice the value of the property or monetary instruments or funds involved in the transaction, whichever is greater, imprisonment of up to 20

years, or both. §1957 criminalizes knowingly engaging or attempting to engage in a monetary transaction in criminally derived property of a value greater than $10,000 and which is derived from specified unlawful activity. With some exceptions, the potential penalty is a fine of up to $250,000 for an individual or up to $500,000 for an organization, or imprisonment of up to ten years, or both.

9.1.3 of the Internal Revenue Manual provides an overview of statutes under the jurisdiction of IRS-CI and lists elements of the crime needed to sustain prosecution.

HOW DOES THE IRS GATHER INFORMATION DURING A CRIMINAL INVESTIGATION?

An IRS criminal investigation typically has the following steps:

- **Preliminary Analysis:** Upon initiating the investigation, IRS-CI conducts a preliminary review. According to the IRM, the Chief of IRS-CI should review and approve the investigation material before it can be elevated to a formal criminal investigation for all "sensitive" investigations, which includes any investigation involving exempt organizations (see IRM 9.4.1.5.3(3) and 9.4.1.5.3(4)(l)).
- **Formal investigation:** During this phase, IRS-CI may gather evidence through a variety of processes and techniques. These include:
  - **Interviews:** The IRS uses interviews to "obtain leads, develop information, and secure evidence" (IRM 9.4.5.1.1). The IRS may interview a person who has knowledge relating to the investigation with or without issuing a summons (see 26 USC §7609(j) and IRM 25.5.4.2(3)).
  - **Administrative summons**: As with audits, the IRS may issue an administrative summons for a nonprofit or its staff to produce documents or provide testimony related to a criminal investigation. The IRS may enforce a summons through a federal district court. The IRS may not issue an administrative summons to a person if it has already referred the person to the Justice Department for prosecution (26 USC §7602).
  - **Grand jury subpoena**: A U.S. Attorney, working with the IRS, may convene a grand jury to issue a subpoena. A subpoena orders a person to testify or provide documents or other information based on probable cause. This can include a subpoena to a third party such as a bank or information services provider. Noncompliance can lead to civil or criminal contempt.
  - **Search warrant**: A federal judge may authorize the IRS to execute a search warrant (see IRM 9.4.9.3.1.1 and 9.4.9.3.1.4). A search warrant allows the government to search a specific location and seize specific items,

authorized by the judge, based on probable cause that a crime occurred and that specific evidence is located at the place to be searched.

- **Surveillance:** The IRS and federal law enforcement may engage in a variety of types of surveillance in a criminal investigation, including active surveillance of a nonprofit's office, use of undercover agents, and monitoring of an organization's public communications (see IRM 9.4.6).

- **Recommendation for prosecution:** If IRS-CI concludes that criminal activity is substantiated, it prepares a written report recommending prosecution, which it will submit to the DOJ. The IRM advises the agent writing the report to obtain the opinions of other specific IRS-CI officials on the sufficiency of evidence gathered, method of proof used, and proposed recommendations before writing the report (IRM 9.5.8.3). If the DOJ accepts the investigation for prosecution, DOJ prosecutors will manage the investigation in preparation for and during the prosecution, not the IRS. Prosecution of federal tax crimes are brought before federal district courts.

HOW DO CRIMINAL INVESTIGATIONS RELATE TO CIVIL AUDITS?

TE/GE may refer an audited case to IRS-CI if it discovers evidence of a potential criminal violation during an audit. For many years, the IRS would suspend a civil investigation if it began a criminal investigation. However, more recently, the IRS has sometimes undertaken parallel investigations, relying on caselaw that allows the government to undertake simultaneous civil and criminal investigations as long as it operates in good faith or refrains from engaging in "deceit or affirmative misrepresentation." (see *U.S. v. Kordel*, 397 U.S. 1 (1970); *United States v. J.K. Stringer*, 521 F.3d 1189 (9th Cir. 2008)). The IRM currently instructs officers engaged in a civil audit to refrain from informing an organization that it is under a simultaneous criminal investigation (IRM 5.1.5.2 and 5.1.5.7). Once the criminal aspects of an investigation are formally closed, the IRS may still pursue civil penalties against the organization or individuals involved.

What protections do nonprofits have during IRS investigations?

Nonprofits have a number of protections during IRS investigations. As noted above, during an audit, a nonprofit may appeal an adverse determination to the Appeals Office or request a review of the audit by the Associate Chief Counsel. Meanwhile, the Internal Revenue Manual advises IRS-CI agents to obtain review and approval from certain IRS officials before referring a criminal case to the DOJ. Other protections during investigations include:

IRS INSTITUTIONAL PROTECTIONS

Statute of limitations for audits. The IRS generally must assess the amount of tax imposed on a nonprofit within three years after it files its Form 990 series return or other tax return (26 USC §6501(a)). However, the IRS may have additional time to complete an assessment if it identifies a substantial omission in a tax return. For example, the IRS has an unlimited amount of time to audit a false or fraudulent return with intent to avoid tax (26 USC §6501(c)).

Statute of limitations for criminal tax offenses. The IRS generally has a three-year statute of limitations for criminal offenses arising from tax law. However, it applies a six-year statute of limitations for certain offenses enumerated in 26 USC §6531, including filing a false tax return under 26 USC §7206(1) and conspiring to evade taxes under 18 USC §371. Additionally, a five-year statute of limitations may apply under 18 USC §3282 for other criminal offenses not enumerated under 26 USC §6531 (See IRM 9.1.3.6.1).

Limits on "unnecessary examinations." The IRS may not subject a nonprofit to "unnecessary" audits or investigations (26 USC § 7605(b)). The IRS may only inspect a nonprofit's books of accounts once per taxable year unless the Treasury Secretary or their designee notifies the nonprofit in writing that another inspection is necessary (26 USC§7605(b)). However, courts have relatively narrowly interpreted what constitutes an "unnecessary" audit as well as whether an action counts as a second investigation.

Challenging an IRS summons. A person who has received an IRS summons may contest it if the IRS seeks to enforce the summons in a federal district court. The U.S. Supreme Court has found that a summons must meet four requirements to be valid: (1) The investigation must have a "legitimate purpose"; 2) the "inquiry must be relevant to that purpose"; 3) the information sought is not already in the IRS's possession; and (4) the IRS has followed all administrative steps required by the Internal Revenue Code (*United States v. Powell,* 379 U.S. 48 (1964)). The Supreme Court has also held that in contesting a summons, a taxpayer has the right to examine IRS officials regarding their reasons for issuing a summons if the taxpayer can "point to specific facts or circumstances plausibly raising an inference of bad faith" (*United States v. Clarke 573 U.S. 248* (2014)). Finally, with some exceptions, the IRS must provide notice to a nonprofit if it summons a third party to gather information (26 USC §7609 and Treasury Regulations §301.7609-1(a)(1)). This notice gives a nonprofit an opportunity to try to quash the summons. Historically, challenges to IRS summonses have been relatively rare.

Support from the Taxpayer Advocate Service. Organizations that feel the IRS may have treated them unfairly during an investigation may seek support from the Taxpayer Advocate Service (TAS), an independent office within the IRS whose role is to protect taxpayer rights. A nonprofit may also seek support from the TAS if it has experienced a delay in the resolution of a tax issue or if the IRS has failed to respond to or resolve an issue by the date promised.

Confidentiality. Except where expressly permitted by law, the IRS is required to keep confidential tax returns and "return information," including records produced during an audit and whether the IRS is, will be, or previously was investigating a taxpayer's return (26 USC §6103(a) and (b)(2)). Violation of this rule by a federal employee is a felony punishable by imprisonment of up to five years, a fine of up to $5,000, or both (26 USC 7213).

Statutory prohibition on political intervention. Federal law explicitly protects taxpayers from politically motivated IRS investigations (civil or criminal). The President, Vice President, any employee of the Executive Office of the President, and the Treasury Secretary are criminally prohibited from requesting the IRS to conduct an audit or criminal investigation of any nonprofit or other taxpayer (See 26 USC §7217). Any IRS employee who receives such a request must report it to the Treasury Inspector General for Tax Administration (TIGTA), the independent watchdog for the IRS. Failure to report a political intervention may be punished by imprisonment of up to 5 years, with a fine of up to $5000, or both (26 USC §7217(d)).

CONSTITUTIONAL AND OTHER LEGAL PROTECTIONS

Right to representation: A nonprofit has the right to retain representation when engaging with the IRS during an audit. Notably, in many situations, the IRS must suspend an interview if a nonprofit requests to consult with a representative (26 USC §7521(b)(2)) and a nonprofit that retains representation does not have to attend interactions with the IRS unless the IRS formally summons it to appear (26 USC §7521(c)). Similarly, during a criminal investigation, a nonprofit and its officers and employees have a Sixth Amendment right to legal counsel.

Attorney-client privilege: The attorney-client privilege may protect legal advice provided to a nonprofit where the privilege has not been waived, though there are limitations to this protection.

Fourth Amendment right against unreasonable search and seizure: During criminal investigations, a nonprofit may also invoke the Fourth Amendment right against unreasonable search and seizure, such as if the IRS seeks to search its office without a warrant.

Fifth Amendment right against self-incrimination: While organizations do not have a Fifth Amendment right against self-incrimination, an officer or employee of an organization does and may invoke this right if asked to provide testimony they reasonably believe may be self-incriminating.

Right to Access Information: The IRS provides routine access to certain IRS records, such as determination letters or a taxpayer's own filings, on its website. Organizations or individuals can also file a Freedom of Information Act (FOIA) request with the IRS to receive additional information, including their case management notes or internal correspondence within the IRS related to their case. The IRS must provide this information unless one of FOIA's relatively narrow exemptions applies.

Unconstitutional Selective Enforcement. A nonprofit may assert a selective enforcement defense during a civil tax audit or litigation, claiming a violation of their constitutional rights to equal protection and due process of law. The standard to succeed in such a claim is relatively high. Courts have generally used a two-part test to determine the merit of selective enforcement claims where the claiming party must show that (1) "others similarly situated have generally been selected for an audit" and (2) this discriminatory conduct is "based upon impermissible considerations such as race, religion, or the desire to prevent the exercise of constitutional rights (See *Penn-Field Industries v. Commissioner of the IRS*, 74 R.C. 720 (1980)). Courts have also used a similar two-part test to determine the merit of a selective enforcement claim in the context of criminal prosecutions (See *United States v. Berrios*, 501 F.2d 1207 (2d Cir. 1974)).

Taxpayer Bill of Rights: The Taxpayer Bill of Rights (TBOR) consolidates rights codified in the Internal Revenue Code to enhance taxpayer understanding of their legal protections, and applies to all interactions between taxpayers, including nonprofits, and the IRS (IRM 4.70.10.1.5). Several of these rights are noted in more detail above.

Tax-exempt status and nonprofit operations during IRS investigations

A nonprofit retains its tax-exempt status until the IRS issues a final adverse determination letter that revokes its status. Even then, a nonprofit may seek a declaratory judgment in federal court to retain its tax-exempt status. The IRS does not have authority to shut down or otherwise control an organization even after it revokes its tax-exempt status. A nonprofit that loses its tax-exempt status can still operate as a taxable entity. However, the IRS may share its investigation findings with state attorneys general or other state offices that oversee charitable organizations. These entities may in turn investigate and shut down a nonprofit found to have engaged in illegal activity. If the IRS terminates a private foundation's tax-exempt status, the foundation may need to pay a federal termination tax. This termination tax can be significant, as it is calculated as the lesser of 100% of the foundation's net assets or its aggregate historical tax benefit from its 501(c)(3) status (26 USC §507(a)).

How a terrorism designation can affect tax-exempt status

Under §501(p) of the tax code, an organization's tax-exempt status will be automatically suspended if the executive branch designates it to be supporting or engaging in terrorist activity as detailed by this provision. Historically, the small number of nonprofits that have had their tax-exempt status suspended under §501(p) have been designated by the Executive Branch under its authority from Executive Order 13224. The IRS does not carry out this designation process, and §501(p) does not require the IRS to conduct an investigation before the suspension. Where an organization has been designated by the Executive branch, an organization can challenge the underlying terrorism designation in federal court and if the court overturns the designation, the organization's tax-exempt status is automatically restored. Learn more about how §501(p) affects tax-exempt status here.

Practical steps nonprofits can take to prepare for IRS oversight

- **Ensure compliance with IRS requirements.** Ensure that relevant decisionmakers and staff are trained to:
  - Ensure accuracy of forms submitted to the IRS, such as the Form 990 series;
  - Ensure compliance with requirements under IRC §501(c)(3), including operating for an exempt purpose, and prohibitions on private inurement, substantial private benefit to private individuals, and political campaign interventions.
  - Monitor developments in IRS rules and enforcement of tax-exempt status requirements. For example, the IRS periodically issues an exempt organizations newsletter that shares developments relevant to nonprofits.
- **Maintain strong internal governance practices**. These could include having robust internal policies on recordkeeping, financial management, conflicts of interest, document retention, whistleblowing, and other topics.
- **Have a plan to respond to an investigation**. Steps might include:
  - Identifying legal and tax professionals with expertise with IRS investigations in advance. There may be different professionals with expertise in audits and IRS criminal investigations, respectively.
  - Establish internal guidance on how staff should respond to IRS information requests. This includes designating a point of contact who will handle all engagement with the IRS and any communication with the public regarding the investigation. Immediately alert counsel if contacted by the IRS in the context of an investigation.

- If a nonprofit is at heightened risk for criminal investigation, have a response plan, including a point person, to engage with law enforcement if they come to the office and train staff on their rights and responsibilities when interacting with law enforcement.
- Plan for state enforcement: The IRS can make referrals to state attorneys general and other regulators to investigate nonprofits. State authorities can also refer cases to the IRS. As such, it is important to have a similar response plan if contacted by state authorities.

Useful IRS resources

- Compliance Guide for 501(c)(3) Public Charities
- How to lose your 501(c)(3) tax-exempt status (*without really trying*)
- Stay Exempt mini-courses

For more information, please contact Lily Liu (lliu@icnl.org) or Nick Robinson (nrobinson@icnl.org).