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## PREVIEW; Bullock v. Internal Revenue Service: *Can Montana Force IRS Oversight of Dark Money Groups?*

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**PREVIEW; *Bullock v. Internal Revenue Service*: Can Montana Force IRS Oversight of Dark Money Groups?**

**Rebekah M. Gryder\***

A hearing is scheduled for 1:30 PM June 5, 2019 at the U.S. District Court for the District of Montana Great Falls Division. Judge Brian Morris will hear arguments on the Defendant's motion to dismiss and the Plaintiff's motion for summary judgment.

**I. INTRODUCTION**

This lawsuit, initiated by Montana Governor Steve Bullock, challenges a 2018 administrative decision by the Internal Revenue Service ("IRS").<sup>1</sup> Under this decision, adopted as Revenue Procedure 2018-38, the IRS no longer requires some 501(c) organizations to submit the names and addresses of donors as part of their return information.<sup>2</sup> Although the IRS did not make this information publicly available, they could use it to determine a group's tax-exempt status.<sup>3</sup> Prior to the promulgation of Revenue Procedure 2018-38, 501(c)(4) groups listed the names and addresses of donors making aggregate contributions over \$5,000 on Schedule B of their Form 990.

Revenue Procedure 2018-38 raises campaign finance concerns, as some 501(c)(4) social welfare organizations become heavily involved in electioneering and campaign activities, and are more colloquially known as "dark money" groups.<sup>4</sup> Revenue Procedure 2018-38 is viewed by many as a relaxation of regulation on money in politics, as it limits the oversight of these "dark money" groups. As an outspoken critic of the current federal campaign finance regulatory system, Governor Bullock continues to pursue policies that ensure transparency in campaign finance.<sup>5</sup> This lawsuit is one such action. Campaign finance reform is also an essential component of his Presidential platform.<sup>6</sup>

As an initial matter, the Court must decide whether the Plaintiffs have standing to bring suit. Should it find there is standing, the question

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<sup>1</sup> See generally Plaintiffs 1st Amended Complaint, *Bullock v. Internal Revenue Service* (Mont. Mar. 13, 2019) (No. 4:18-CV-00103-BMM).

<sup>2</sup> Rev. Proc. 2018-38. The new rules apply to all 501(c) groups that are not 501(c)(3) charitable organizations, who are still subject to a high level of scrutiny in the exemption determination process. *Id.*

<sup>3</sup> Internal Revenue Service, *Public Disclosure and Availability of Exempt Organizations Returns and Applications: Contributors' Identities Not Subject to Disclosure* (Apr. 2, 2018) <https://www.irs.gov/charities-non-profits/public-disclosure-and-availability-of-exempt-organizations-returns-and-applications-contributors-identities-not-subject-to-disclosure>.

<sup>4</sup> Opensecrets.org: The Center for Responsive Politics, *Outside Spending by Nondisclosing Groups, Cycle to Date, Excluding Party Committees* (Dec. 18, 2018) [https://www.opensecrets.org/outsidespending/nonprof\\_summ.php](https://www.opensecrets.org/outsidespending/nonprof_summ.php)

<sup>5</sup> I.R.C. § 527 (2018).

<sup>6</sup> Governor Steve Bullock, *Office of Governor Steve Bullock* <http://governor.mt.gov/Issues#campaign> (Last visited May 18, 2019).

<sup>6</sup> *Id.*

becomes whether Revenue Procedure 2018-38 was promulgated in violation of the Administrative Procedures Act (“APA”). If the Court grants the Plaintiff’s motion for summary judgment, the Revenue Procedure will be set aside and the IRS would need to comply with the APA in adopting similar rules that alter the information the IRS collects. Regardless of the district court’s decision, this case will likely reach the United States Court of Appeals for the Ninth Circuit.

## II. FACTUAL AND PROCEDURAL BACKGROUND

On July 24, 2018, Montana Governor Steve Bullock filed suit in Federal District Court against the Internal Revenue Service, challenging Revenue Procedure 2018-38.<sup>7</sup> On March 13, 2019, the State of New Jersey joined the lawsuit.<sup>8</sup> The IRS moved to dismiss the suit on March 27, 2019 on two grounds: (1) that Governor Bullock and New Jersey lacked standing to bring suit; and (2) there was no wrongdoing under the APA in promulgating Revenue Procedure 2018-38 because Congress delegated such authority to the IRS.<sup>9</sup> The IRS primarily alleges that both Governor Bullock and New Jersey (“Plaintiffs”) lack Article III standing because they have no legally protected interest in the information and have not suffered any harm caused by the new revenue procedure.<sup>10</sup> Plaintiffs subsequently moved for summary judgment, alleging that they have informational standing to bring suit and that Revenue Procedure 2018-38 was promulgated in violation of the APA.

## III. SUMMARY OF THE ARGUMENTS

The Montana Department of Revenue and other state regulatory agencies may, upon request, receive and rely on information submitted on federal tax documents, such as a Schedule B donor report, to promulgate its rules and regulations.<sup>11</sup> Names and addresses of donors can be used by state authorities to examine an organization’s source of funding, and make determinations of its tax-exempt status in that state. Under Montana law, an organization cannot obtain a tax-exempt status if any part of their net income benefits a private shareholder or individual.<sup>12</sup> Under New Jersey law, charitable organizations, which may be organized as a 501(c)(4), must provide the state with a copy of all IRS filings.<sup>13</sup> Thus, Plaintiffs argue that both states rely on the “strength of the federal tax exemption process, including the vigorous reporting requirements” to make their own tax-

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<sup>7</sup> Complaint, *Bullock v. Internal Revenue Service* (Mont. Jul. 24, 2018) (No. 4:18-CV-00103-BMM).

<sup>8</sup> Plaintiffs 1st Amended Complaint, *supra* note 1.

<sup>9</sup> Defendant’s Second Motion to Dismiss, *Bullock v. Internal Revenue Service* (Mont. Mar. 27, 2019) (No. 4:18-CV-00103-BMM).

<sup>10</sup> *Id.*

<sup>11</sup> See e.g. I.R.C. § 6103(d), 6104(c).

<sup>12</sup> Mont. Code Ann. § 15-31-102(1) (2019).

<sup>13</sup> N.J. Admin. Code § 13:48-4.1(b)(7) (2019).

exempt determinations,<sup>14</sup> and Revenue Procedure 2018-38 harms the Plaintiff's ability to administer its laws.<sup>15</sup>

Additionally, Plaintiffs allege that when promulgating Revenue Procedure 2018-38, the IRS acted in violation of the rulemaking procedures set forth by the APA, conducted arbitrary and capricious rulemaking in violation of the APA, and engaged in unauthorized agency action.<sup>16</sup> Plaintiffs seek to have Revenue Procedure 2018-38 set aside by the Court.<sup>17</sup>

#### *A. Internal Revenue Service's Motion to Dismiss*

Defendants argue that the Plaintiffs do not have standing to challenge Revenue Procedure 2018-38, and that Plaintiffs have no legally protected interest in receiving the donor information from the IRS and thus their harm is merely hypothetical.<sup>18</sup> Defendants establish that neither Montana nor New Jersey have ever requested Schedule B information from the IRS, and New Jersey specifically, already receives such information directly from tax-exempt organizations.<sup>19</sup> Defendants argue that Internal Revenue Code § 6103(d) does not provide a statutory basis sufficient to establish "informational standing" because donor information is not specifically guaranteed under the plain text of the statute.<sup>20</sup>

Next, defendants argue that Revenue Procedure 2018-38 did not require the proper notice and comment procedures outlined in the APA.<sup>21</sup> Defendants argue that the Revenue Procedure is an interpretive rule, as opposed to a legislative rule because the procedure merely clarified the language of I.R.C. § 6033 and did not make any substantive changes to the law.<sup>22</sup> Further, Defendants maintain that Congress specifically delegated the type of rulemaking authority that Revenue Procedure 2018-38 represents to the IRS alone.

#### *B. Governor Bullock & New Jersey's Motion for Summary Judgment*

Plaintiffs primarily argue that the Revenue Procedure was promulgated in violation of the APA, and that the IRS should be required to follow proper notice and comment procedures when enacting such guidance.<sup>23</sup> Therefore, as a matter of law, the revenue procedure should be

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<sup>14</sup> Plaintiffs 1st Amended Complaint, *supra* note 1, at ¶ 51.

<sup>15</sup> *Id.* at ¶¶ 53, 65.

<sup>16</sup> *Id.* at ¶¶ 81–106.

<sup>17</sup> *Id.* at ¶ a.

<sup>18</sup> Defendant's Second Motion to Dismiss, *supra* note 9 at 14.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 13.

<sup>21</sup> Combined Reply in Support of Motion to Dismiss and Response to Motion for Summary Judgment at 33–41, *Bullock v. Internal Revenue Service* (Mont. May. 8, 2019) (No. 4:18-CV-00103-BMM).

<sup>22</sup> Defendant's Second Motion to Dismiss, *supra* note 9 at 34.

<sup>23</sup> Plaintiffs 1st Amended Complaint, *supra* note 1, at ¶¶ 81–106.

set aside.<sup>24</sup> Additionally, under federal law a state agency may, from time to time, request federal return information when making tax-exempt determinations or merely to compare state and federal returns to ensure compliance with applicable law.<sup>25</sup> Plaintiff Governor Bullock further alleges that, under the new regulations, the Montana Department of Revenue's ("MTDOR") ability to conduct private inurement determinations for certain tax-exempt organizations is harmed because it may no longer be able to request Schedule B donor information, which diminishes their ability to rely on federal tax-exempt determinations.<sup>26</sup>

In response to Defendant's attack on standing, the Plaintiffs argue that they have a statutory right to obtain the Schedule B information and thus suffered an "informational injury" sufficient to create standing.<sup>27</sup> They argue that § 6103(d) provides such statutory right to the Schedule B information and that failure by the IRS to observe notice and comment requirements of the APA before discontinuing collection of donor information gives rise to standing.<sup>28</sup> Alternatively, Plaintiffs argue that they have standing because Revenue Procedure 2018-38 unlawfully interferes with their ability to enforce their laws and has caused them to divert their resources in response to the action.<sup>29</sup> New Jersey alleges that it has had to expend state resources finalizing new rules directly in response to Revenue Procedure 2018-38.<sup>30</sup>

#### IV. ANALYSIS

##### A. Standing

The Court's decision may hinge on whether, as a matter of statutory interpretation, MTDOR and New Jersey can establish a statutory right to receive donor information previously contained on Schedule B of a form 990. Here, the parties dispute the meaning of I.R.C. § 6103, and whether it provides a legal basis for standing to bring suit.<sup>31</sup> Standing requires an "injury in fact" or a threatened injury that is "certainly impending."<sup>32</sup> Injury sufficient to show standing can arise when there is a demonstrated informational injury,<sup>33</sup> which may exist when a plaintiff has a statutory right to obtain that information, and can no longer do so.<sup>34</sup>

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<sup>24</sup> *Id.* at Prayer for Relief a.

<sup>25</sup> I.R.C. § 6103(d).

<sup>26</sup> Plaintiffs' Combined Brief in Support of Summary Judgment and Response to Motion to Dismiss at 16, *Bullock v. Internal Revenue Service* (Mont. Apr. 17, 2019) (No. 4:18-CV-00103-BMM).

<sup>27</sup> Plaintiffs' Combined Brief in Support of Summary Judgment and Response to Motion to Dismiss, *supra* note 26, at 28–31.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 38–49.

<sup>30</sup> *Id.* at ¶ 61.

<sup>31</sup> See Defendant's Second Motion to Dismiss, *supra* note 9, at 5; Plaintiffs' Combined Brief in Support of Summary Judgment and Response to Motion to Dismiss, *supra* note 26, at 31–34.

<sup>32</sup> *Clapper v. Amnesty Int'l USA*, 568 U.S. 398, 409 (2013).

<sup>33</sup> See *FEC v. Atkins* 524 U.S. 11 (1998).

<sup>34</sup> See e.g. *Citizens for Responsibility and Ethics in Washington v. Exec. Office of the President*, 587 F.Supp.2d 48, 59–61 (D.D.C. 2008).

The difficult issue before the Court to tackle is whether this statute can create the requisite interest in specific information collected on returns, as opposed to merely the information which the IRS prescribes should be contained in returns. This determination will depend entirely on how the Court reads § 6103(d). Plaintiffs assert that Internal Revenue Code § 6103(d) provides the statutory basis requisite to create standing.<sup>35</sup> Under section 6103, “returns and return information with respect to taxes imposed . . . shall be open to inspection by, or disclosure to, any State agency.”<sup>36</sup> Defendants argue that this section only guarantees the information about taxes *imposed*, which would not include return information when no tax is imposed upon that group. Thus, Defendants argue, no longer providing *tax-exempt* groups’ donor information does not fall within the plain language informational guarantee of the statute.<sup>37</sup> Nor does the statute create an informational interest in what specific information should be collected on the returns.<sup>38</sup> The Plaintiffs maintain that this strict a reading of the statute is pedantic, and would suggest that they could not access the return information of *any* organization which did not pay taxes in the given year—which is not what the legislature intended.<sup>39</sup> They argue, instead, that the statute should be read to give a statutory guarantee to access to the information about tax status, which would include Schedule B information. The Court may allow standing in order to reach the substantive issues of this matter.

### *B. The Administrative Procedures Act*

The APA requires notice and comment procedures for certain changes in rulemaking by agencies.<sup>40</sup> However, interpretive, procedural, or practice rules, or rules that “merely explain, but do not add to, the substantive law that already exists in the form of statute or legislative rule,” do not require notice and comment procedures.<sup>41</sup> Legislative rules, which fall under the procedures set forth by the APA, “create rights, impose obligations, or effect a change in existing law.”<sup>42</sup> The Defendants maintain that Revenue Procedure 2018-38 is an interpretive rule because it specifies what “other information” the IRS may collect from certain exempt organizations under Internal Revenue Code § 6033.<sup>43</sup> The Plaintiffs respond that 26 C.F.R. § 1.6033-2(a)(2)(ii) specifies what “other information” under section 6033 was required.<sup>44</sup> § 1.6033-2(a)(2)(ii), prescribes information exempt organizations should provide to the IRS,

<sup>35</sup> Plaintiffs’ Combined Brief in Support of Summary Judgment and Response to Motion to Dismiss, *supra* note 26, at 28–34.

<sup>36</sup> I.R.C. § 6103(d).

<sup>37</sup> Defendant’s Second Motion to Dismiss, *supra* note 9, at 5.

<sup>38</sup> *Id.*

<sup>39</sup> Plaintiffs’ Combined Brief in Support of Summary Judgment and Response to Motion to Dismiss, *supra* note 26, at 31–34.

<sup>40</sup> 5 U.S.C. § 533(b)–(c).

<sup>41</sup> *Hemp Indus. Ass’n v. DEA*, 333 F.3d 1082, 1087 (9th Cir. 2003); 5 U.S.C. § 533(b)(3)(A).

<sup>42</sup> *L.A. Closeout, Inc. v. Dep’t of Homeland Sec.* 513 F.3d 940, 942 (9th Cir. 2008).

<sup>43</sup> Defendant’s Second Motion to Dismiss, *supra* note 11, at 27.

<sup>44</sup> Plaintiffs’ Combined Brief in Support of Summary Judgment and Response to Motion to Dismiss, *supra* note 26, at 19–22.

and includes names and addresses of donors contributing \$5,000 or more.<sup>45</sup> Therefore, if this regulation does specify what “other information” means, then Revenue Procedure 2018-38 would effectively amend § 1.6033-2, making it a legislative rather than an interpretive rule. Should the Court find that Revenue Procedure 2018-38 is a legislative rule, the rule should be set aside until the IRS observes the appropriate notice and comment procedures prescribed by the APA.

## V. CONCLUSION

The Court must decide whether a state has standing to bring a lawsuit against a federal regulatory agency when it no longer collects information that could, at one point, be provided to states for use in administering its own laws. Here, the Court’s interpretation of I.R.C. § 6103(d) will be key in determining whether the Plaintiffs can move forward in their action against the IRS. Further, the Court must decide whether Revenue Procedure 2018-38 is an interpretive or legislative rule, and thus whether it requires compliance with the rulemaking procedures under the APA. If the Court finds it is a legislative rule, Revenue Procedure 2018-38 will be set aside and the IRS will need to observe requirements under the APA before altering the information they collect from 501(c) groups. Contrarily, if the Court finds the rule is merely interpretive, many “dark money” groups will operate with even less oversight.

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<sup>45</sup> Treas. Reg. § 1.6033-2(a)(2)(ii)(f).