

A Level Playing Field: A Challenge to Special Treatment of Section 501(c)(3) Applications Moves Forward.

Qualification as a tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code carries a variety of benefits, including the ability of donors to claim a deduction for contributions. To qualify for these benefits, an entity will file an application requesting that the IRS determine that it is entitled to tax exempt status under Section 501(c)(3).

Last week, the United States District Court for the District of the District of Columbia issued a very interesting opinion dealing with a claim that a particular entity seeking tax exempt status was subjected to special procedures due to the views that it espoused. *Z Street, Inc. v. Koskinen*, 2014 U.S. Dist. LEXIS 71638 (D.D.C. May 27, 2014).

Z Street was formed for the purpose of educating the public about various issues relating to Israel and the Middle East. Shortly after it was formed, it applied for a determination that it was tax-exempt under Section 501(c)(3) of the Code. When Z Street's counsel called the IRS agent assigned to the request to review its status, he was advised that its application had been sent to a special unit for review because the IRS had a special procedure for applications from organizations related to Israel that held positions that were not consistent with current U.S. policy. *Z Street*, 2014 U.S. Dist. LEXIS, slip op. at *5-*6.

In response, Z Street filed suit against the Commissioner of Internal Revenue, asserting that the IRS had violated the first amendment by imposing additional procedures on its application for tax exempt status based on its views, an exercise in viewpoint discrimination. Z Street sought a declaration that the IRS policy violated the first amendment and an injunction barring the IRS from applying its policy to the consideration of Z Street's application. *Id.*, slip op. at *6-*7. In response, the government moved to dismiss, arguing that Z Street's action was barred by the Anti-Injunction Act, the tax exception to the Declaratory Judgment Act, and sovereign immunity. It also asserted that Z Street was not entitled to equitable relief since it lacked an adequate remedy at law. The district court denied the government's motion, rejecting each of its arguments.

First, the court concluded that the action was not barred by either the Anti-Injunction Act or the tax exception to the Declaratory Judgment Act because Z Street's complaint did not seek to restrain the assessment and collection of a tax. *Id.*, slip op. at *21-*26. Here, the primary rationale was that Z Street's concern was with the procedures being applied to its application, making the case analogous to *Cohen v. United States*, 578 F.3d 1 (D.C. Cir. 2009), which held that a challenge to special refund procedures was not barred by the Anti-Injunction Act or the tax exception to the Declaratory Judgment Act. In the court's view the relief requested by Z Street had no direct implications for the assessment and collection of taxes, since Z Street merely sought a directive that the IRS review its qualification under Section 501(c)(3) in the normal way, without special procedures. *Z Street*, 2014 U.S. Dist. LEXIS, slip op. at *27-*28.

Second, the court rejected the government's contention that Z Street's claim was barred by sovereign immunity. Here, the court reasoned that the Administrative Procedure Act supplied the requisite waiver of sovereign immunity. *Id.*, slip op. at *37-*38 (citing 5 U.S.C. § 702). The court also rejected the government's effort to graft a requirement that there be final agency action onto a claim based upon the constitution, ruling that final agency action was required for

claim based upon the APA, but not for a claim with another basis to fit within the waiver of sovereign immunity. *Id.*, slip op. at *41-*44.

Finally, the court concluded that Z Street could pursue equitable relief because it lacked an adequate remedy at law, rejecting the government's contention that Z Street remained free to challenge the final determination of its status under Section 7428 of the Code or to pursue a deficiency action or a refund action. In the court's view, none of these alternatives would address Z Street's basic contention that the process used to review its application violated the first amendment. *Id.*, slip op. at *45-*53.

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