

# IRS EXEMPT ORGANIZATIONS FY 2012 ANNUAL REPORT & FY 2013 WORKPLAN



## LETTER FROM THE DIRECTOR

Greetings,

FY 2012 was another busy year for Exempt Organizations (EO) — full of projects, legislation implementation, compliance, determinations and outreach work. In FY 2013, we will be moving to the next steps in much of that work, as well as beginning some new efforts.



We appreciate the exempt sector’s interest in EO’s annual reports and workplans, and we strive to make them as informative as possible. Although past workplans have given you a general description of our projects, we haven’t provided much information about what we do behind the scenes to prepare for and implement them. I believe that has created a mismatch between your expectations of when a project will be completed and our reality of what it takes to execute and finalize a project. So, beginning with the FY 2012 Annual Report and FY 2013 Workplan, we will work to provide you with a clearer picture of the many elements that make up a project and give you a better sense of which elements we will be taking on within a particular fiscal year. We believe this approach will enable us to provide you with better, more timely information about ongoing projects.

Many of EO’s projects are complex and require sophisticated planning and execution, so they rarely fit conveniently into a fiscal or calendar year and may go through several phases over their lifetimes. Phases can include:

- Project planning
- Questionnaire development
- Statistical sample design
- Specialized training for our revenue agents
- Focused data gathering — both internally and externally
- Data analysis and issue identification
- Examinations

Add to that the fact that the work on a particular project must accommodate other ongoing priority work assigned to staff. Coordination among the various offices that have pieces of the projects — Rulings and Agreements, Review of Operations, EO Compliance Unit, Determinations, Research, and Customer Education and Outreach — is sometimes challenging.

Despite the challenges, EO is committed to looking for ways to increase transparency about the status and findings of our projects by providing a clearer picture of our fiscal year goals and reporting on interim findings where possible. We hope this approach will provide the sector with a better understanding of how EO balances targeted projects with the overall compliance, determinations, guidance and education activities our stakeholders expect from us.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

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# Organizational Information

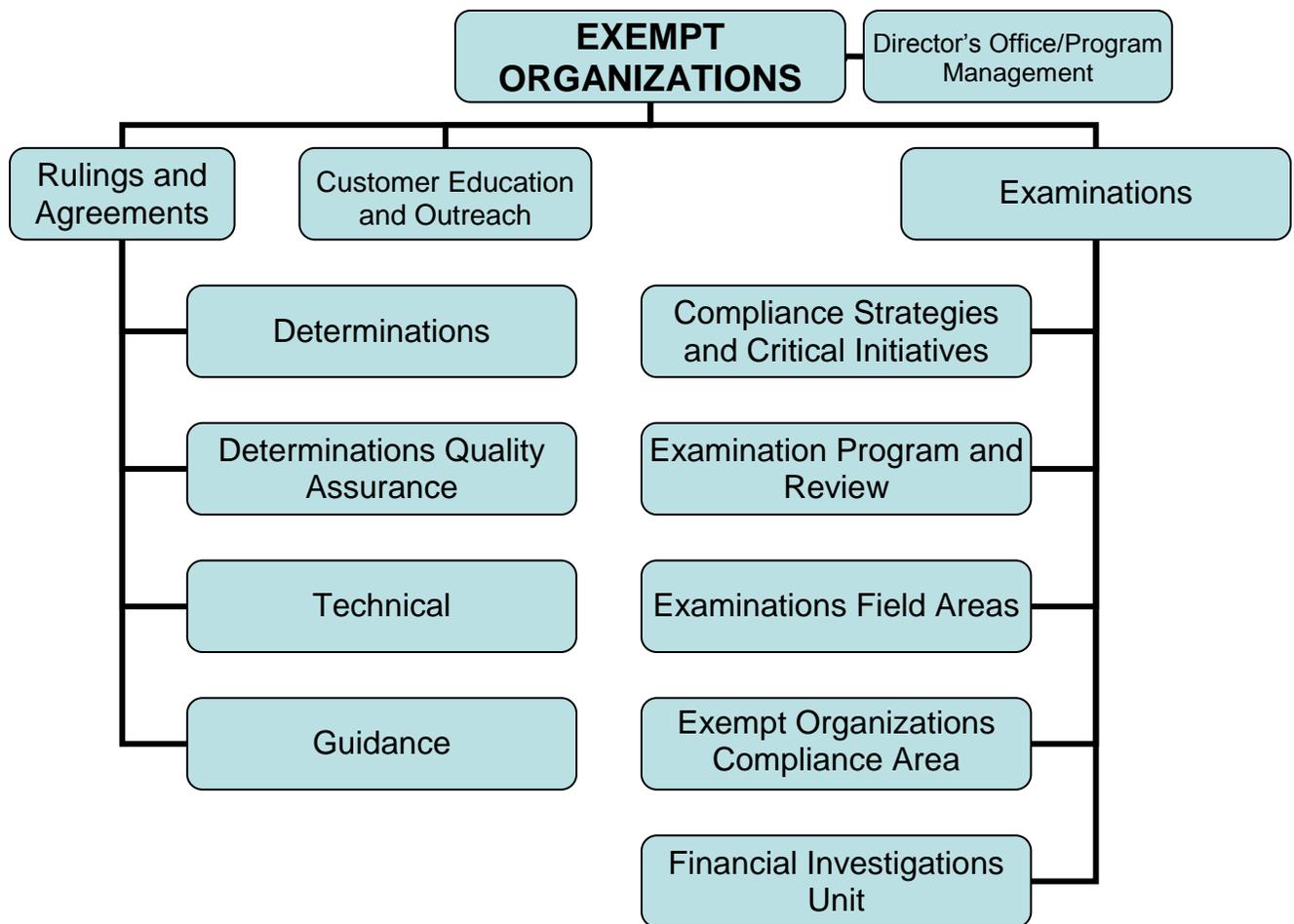
## Exempt Organizations Staffing

Exempt Organizations (EO) is organized by three functional areas: Rulings and Agreements, Examinations, and Customer Education and Outreach.

Figure A: Employees over a 3-year period

	Rulings and Agreements	Examinations	Customer Education and Outreach	Director's Office/Program Management	Total
<b>2010</b>	337	538	13	12	900
<b>2011</b>	332	531	12	14	889
<b>2012</b>	335	516	12	13	876

Figure B: Organizational chart



# GLOSSARY

## **Compliance Strategies and Critical Initiatives (CSCI)**

Identifies areas of noncompliance and develops strategies to improve compliance through examinations, compliance checks, educational programs and other activities that may not involve the examination of books and records.

## **Customer Education and Outreach (CE&O)**

Develops and delivers programs and products designed to help exempt organizations understand their tax responsibilities. Supports the development of internal and external communications, forms and publications and external education and outreach efforts.

## **Determinations**

Processes applications for tax exempt status under [IRC 501\(a\)](#) and [IRC 521](#), along with certain other requests. This includes reviewing applications, determining whether the information provided by the applicant meets legal requirements, and issuing determination letters.

## **Determinations Quality Assurance**

Provides technical and procedural accuracy reviews of determination cases, provides feedback to determination groups on quality of work products and errors, and provides technical assistance to managers and employees.

## **Examinations**

Analyzes the operation and finances of exempt organizations through examinations (audits). Exam agents propose tax assessments or changes to exempt status when necessary, as well as advise organizations about how to comply with the law in the future.

## **Examinations Field Areas**

Exam managers and agents are situated in five geographical areas:

- Great Lakes: Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Nebraska, North Dakota, South Dakota, Wisconsin
- Gulf Coast: Alabama, Arkansas, Florida, Georgia, Kansas, Louisiana, Mississippi, Missouri, Oklahoma, Tennessee, Texas
- Mid-Atlantic: Delaware, Maryland, North Carolina, Ohio, Pennsylvania, South Carolina, Virginia, West Virginia, Washington, DC
- Northeast: Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont
- Pacific Coast: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Oregon, Nevada, New Mexico, Utah, Washington, Wyoming

## **Examinations Program and Review (EPR)**

Responsible for EO Examinations program planning, monitoring and analysis; work plan; training plan development and monitoring; reports and briefings; workload studies; case selection, building and delivery; processing claims; screening and classifying all referrals; performing technical and procedural accuracy reviews of field examination cases; providing feedback to examination groups on quality of work products and errors; and providing technical assistance to managers and employees.

## **Exempt Organizations (EO)**

IRS division responsible for oversight of the large and diverse sector of nonprofits — charities, foundations, churches and others — that are exempt from federal income tax. EO works to increase the sector's understanding of compliance requirements for federal tax-exempt status and promotes transparency, accountability and effective governance throughout the tax-exempt sector.

### **Exempt Organizations Compliance Area (EOCA)**

Brings organizations into compliance using compliance checks, questionnaires and correspondence examinations. EOCA's Review of Operations (ROO) also conducts non-contact compliance reviews of exempt organizations' operations and activities to ensure they are operating in accordance with their exempt purposes. Where appropriate, they may refer organizations for examination.

### **Financial Investigations Unit (FIU)**

Staffed with fraud specialists, forensic accountants and agents with expertise in identifying fraud and tracking foreign grant activities, FIU detects and deters fraudulent transactions in the exempt organization community by examining organizations identified as potentially involved in fraud. Additionally, the staff works jointly with law enforcement agencies, such as the Joint Terrorism Task Force and the Criminal Investigation Division, to support criminal investigations and expert testimony at trials.

### **Guidance**

Provides formal and informal guidance that explains how certain laws, such as regulations, revenue rulings, revenue procedures, notices and announcements, may apply to exempt organizations.

### **Director's Office/Program Management**

Supports the Director, EO and all of EO's functional areas, tracks EO's budget, monitors hiring and promotions, measures and reports EO's performance and performance goals internally, and helps ensure that EO is responsive to the needs of TE/GE HQ and the Commissioner.

### **Rulings and Agreements (R&A)**

Composed of Determinations, Determinations Quality Assurance, EO Technical and EO Guidance. R&A processes applications for tax exemption and provides direction through private letter rulings, technical advice memoranda and formal and informal guidance; responds to taxpayer and Congressional correspondence, and supports EO Examinations initiatives with technical advice and the development of questionnaires, checksheets and reports.

### **Technical**

Provides direction through private letter rulings and technical advice memoranda and processes complex applications for exemption.

# Examinations

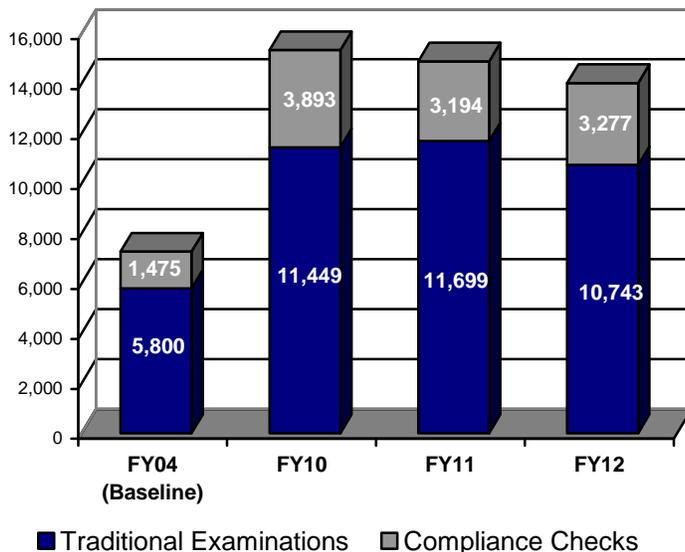
EO Examinations enforcement activities in FY 2012 included both compliance checks and traditional examinations. EO uses these techniques to maximize its reach as well as focus on specific issues.

In a typical compliance check, we contact an individual organization by letter when we discover an apparent error on a return. We also use compliance check questionnaires to study specific parts of the tax-exempt community or specific cross-sector practices. We request completion of the questionnaires by organizations matching the profile we want to learn about.

Traditional examinations, also known as audits, are authorized under § 7602 of the Internal Revenue Code. For exempt organizations, an examination determines an organization’s continued qualification for tax-exempt status. We conduct two different types of examinations: field and correspondence.

In a field examination, the EO revenue agent performs the work at the organization’s place of business. In a correspondence examination, an organization mails documents to the IRS office where the EO agent is located. Over three-fourths of the traditional examinations completed in FY 2012 were field exams.

Figure C: Total number of returns



## Examinations

*Since the redesigned Form 990 was introduced, EO Examinations has used the form’s expanded data to better identify patterns of noncompliance, understand the causes and target potential offenders. The effectiveness of this process relies, however, on accurate reporting by Form 990 filers. Inaccurate or incomplete reporting may give the appearance of noncompliance, and that may lead us to examine an organization unnecessarily – something you and we want to avoid.*

*EO believes that education and compliance go hand in hand. In FY 2013, Examinations will work with EO Customer Education and Outreach to expand our efforts to help organizations understand clearly what is expected of them to keep their tax-exempt status.*



Nanette Downing  
Director, EO Examinations

# Rulings and Agreements

One of the offices in EO Rulings and Agreements (R&A) is EO Technical. EO Technical is located in Washington, DC and is staffed by roughly 40 tax law specialists. Traditionally, EO Technical has been thought of as the function within EO that is responsible for [private letter rulings](#) (PLRs) and [technical advice memoranda](#) (TAMs). In the present workplace, however, EO Technical does many things in addition to those two activities.

EO Technical provides critical technical assistance to other parts of EO. EO Technical is actively involved in compliance projects. It works with EO Exam to develop questionnaires and checksheets, and it drafts reports on the results of compliance projects. EO Technical also works closely with EO Customer Education and Outreach (CE&O). It conducts technical review of all publications, IRS website material and outreach materials like scripts for webinars, workshops and presentations. A number of EO Technical's tax law specialists participate in the outreach events CE&O organizes throughout the country.

EO Technical works with EO Guidance to respond to correspondence from exempt organizations, the general public and members of Congress. In FY 2012, EO Technical/EO Guidance received over 300 pieces of general correspondence and almost 400 pieces of correspondence from members of Congress. EO Technical also works with EO Guidance to revise related EO chapters within the Internal Revenue Manual.

EO Technical provides technical assistance to EO Determinations as well as works applications itself. Certain applications for recognition of exemption, including cases where there is not well-established precedent that thus require interpretation of the tax law, are handled by EO Technical. Applications now compose more than 30 percent of EO Technical's total workload. By contrast, PLRs and TAMs combined compose roughly 15 percent of EO Technical's total workload.



*As EO Technical's responsibilities have grown, we have looked for ways to better meet these competing demands. For example, over the last several years, EO Technical has implemented a number of measures to reduce the time it takes to process PLRs, TAMs and applications.*

*Those efforts are beginning to have an impact. In FY 2012, EO Technical reduced the number of its cases that are over two years old by more than 50 percent. EO Technical is committed to continuing to build on these improvements to make the PLR and application process as efficient as possible for taxpayers.*

Holly Paz  
Director, EO Rulings and Agreements

# Customer Education and Outreach

In FY 2012, EO's Customer Education and Outreach (CE&O) office explored new ways to deliver programs and products virtually, which cut costs and broadened our audience. CE&O piloted a virtual workshop on a popular presentation topic that had been delivered previously by live speakers and was in high demand. CE&O's presentation, entitled *What You Need to Know About Automatic Revocation of Exemption*, was originally created in response to a request for a speaker for a series of events for tax practitioners in California. The presentation was delivered virtually, and an IRS speaker was available via speakerphone for live Q&A.

After its initial success in California, CE&O used the presentation at multiple other events for the remainder of the year, including briefings for congressional staffers in Texas, Georgia and New York. It has been used as both a stand-alone topic and integrated into larger presentations.

Figure D: Stakeholders reached through EO's education and outreach efforts

Outreach Efforts	FY 2010	FY 2011	FY 2012
EO Update subscribers	130,176	183,516	189,578
Attendees at speeches, tax forums, webinars, and workshops	32,111	41,252	30,688
<a href="http://IRS.gov/charities">IRS.gov/charities</a> website views	5,333,380	5,242,943	4,827,351

EO maintained its core educational activities and continued to focus on new ways to engage and educate internal and external stakeholders. In FY 2012, EO's Customer Education and Outreach office:

- Offered 35 full-length and three shorter sessions of our day-long introductory workshops for small and medium-sized tax exempt organizations, in collaboration with 29 academic hosts in 34 cities in 18 states
- Supported the production and delivery of a writing course for EO Examinations Revenue Agents called *Express Yourself*
- Produced [three webinars](#) and three phone forums on select topics of interest to tax-exempt organizations and tax practitioners
- Issued 20 editions of the [EO Update](#) e-newsletter to help keep the tax-exempt sector informed about IRS policies and developments

*In FY 2013, CE&O plans to build on the great success we had last year with stakeholder partnerships and virtual presentations. Traditionally, we've sent IRS experts to speak to groups around the country. Because our travel budget is limited, we will focus our in-person outreach on larger groups. Technology and virtual content are going to help us fill the gap with smaller organizations.*

*Like the example cited on the top left of this page, we're going to deliver more of our speakers' materials virtually, with an EO expert on the phone live to answer questions for participants.*

*We're more interested than ever in building stakeholder partnerships. Adding more virtual offerings is going to let us extend our reach — without the cost of an airplane ticket.*



Melaney Partner  
Director, EO Customer Education and Outreach

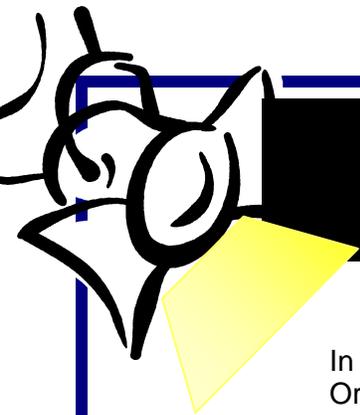
# Federal-State Coordination

The Internal Revenue Code allows the IRS to disclose certain information about exempt organizations to state charity regulators that meet specified disclosure eligibility requirements. State charity regulators also provide information to the IRS about potential tax law violations occurring in their jurisdictions. This two-way exchange benefits both Exempt Organizations (EO) and state enforcement authorities.

EO has seen an increase in the number of referrals from state charity regulators and tax agencies of more than 70 percent over the past six years. In FY 2011 alone, the IRS received 104 referrals from state officials from 19 different states. Many of the common issues that are referred to the IRS involve:

- Private benefit and inurement
- Nonfilers
- Political activities by § 501(c)(3) organizations
- Employment tax issues
- Organizations not operated as required by their exempt status

At present, eight state tax and charity agencies in seven different states have met the disclosure eligibility requirements for IRS information sharing. In FY 2011, EO made approximately 27,000 disclosures to these eight agencies. The information included proposed and final revocations of tax exemption for § 501(c)(3) organizations, proposed and final notices of deficiency for Chapter 42 excise taxes for these organizations, approved § 501(c)(3) exempt organization applications, as well as proposed and final denials of these applications.



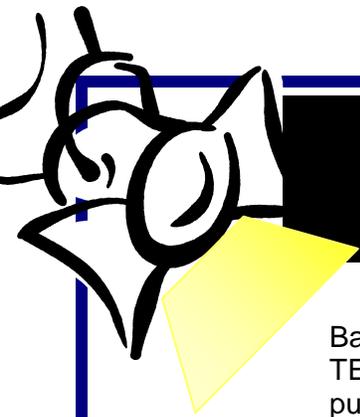
# AFFORDABLE CARE ACT

In coordination with the Department of the Treasury and IRS Chief Counsel, Exempt Organizations (EO) continued in FY 2012 to implement the provisions of the Affordable Care Act of 2010 (ACA) that affect charitable hospitals, exempt organizations as small employers, and the tax practitioner community.

EO's activities in FY 2012 included:

- Continuing to revise Form 990, Form 990 Schedule H, and their instructions to enable hospital organizations to report whether and how they are complying with new requirements for tax-exempt hospitals.
- Issuing proposed regulations on new requirements for charitable hospitals under § 501(r). The proposed regulations address financial assistance policies, limitations on charges, and billing and collection requirements.
- Reviewing comments received in response to [Notice 2011-52](#) and working on guidance regarding the community health needs assessment requirements under § 501(r), which are effective for tax years beginning after March 23, 2012.
- Continuing to conduct the statutorily required community benefit reviews. In FY 2012, EO reviewed the community benefit activities of hospital organizations. EO will continue to use the information gathered from the reviews for research, reporting and compliance purposes, as well as to identify areas where additional guidance, education or Form 990 changes are needed.
- Educating tax-exempt employers about the ACA's Small Business Health Care Tax Credit.
- Providing information ([Fact Sheet 2011-11](#)) for tax-exempt organizations participating in the Medicare Shared Savings Program (MSSP) through an Accountable Care Organization. The ACA established the MSSP, which encourages ACOs to facilitate cooperation among providers to improve the quality of care provided to Medicare beneficiaries and reduce unnecessary costs.
- Processing applications from organizations under new § 501(c)(29), which provides for exemption for Cooperative Health Insurance Issuers that meet certain requirements.
- Soliciting public comment on IRS proposals and providing outreach and education to improve exempt entities' understanding of the changes and new requirements.

As we move forward, the IRS will continue to work closely with the tax-exempt health care sector as we fully implement the ACA. EO will use the information gathered under new ACA requirements to further its research and risk modeling, which improves transparency and compliance.



# GOVERNANCE

Based on comments in the 2008 report on governance by the Advisory Committee to TE/GE (ACT), EO undertook a study of the impact of various governance practices of public charities selected for audit.

## **Governance Study—Preliminary Results**

EO has completed its analysis of 1,300 checksheets from 501(c)(3) organizations, and has produced preliminary findings. Because this analysis included only public charities that already had been selected for examination based on other criteria, the results are not statistically representative of the overall population. They do, however, provide an interesting starting point and offer some insight into which governance practices might be useful indicators of tax compliance.

The presence of the following factors was associated with compliance for the group that we reviewed:

- Have a written mission statement
- Always use comparability data when making compensation decisions
- Have controls in place to ensure the proper use of charitable assets
- Provide for Form 990 review by the entire board of directors before filing

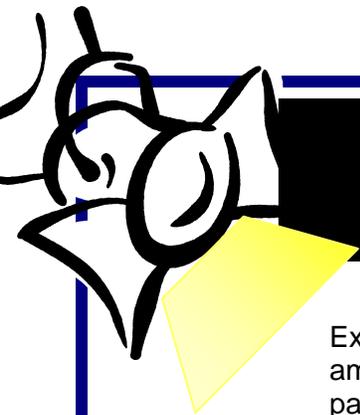
On the other hand, the factor of having control of the organization concentrated in one individual, or in a small, select group of individuals, was associated with noncompliance.

In light of the initial findings, in FY 2013, EO will examine a statistical sample of 501(c)(3) and 501(c)(4) organizations using a checksheet to gather information on their governance practices. As we continue our work in this area, we will look at whether other factors or practices are relevant.

## **Significant Diversion of Assets**

In addition to the governance checksheet study, EO also looked at the tax filings and publicly available online information of 285 organizations that reported a significant diversion of assets on their 2009 Forms 990.

To learn more about whether and how governance practices may have contributed to these significant diversions of assets, in FY 2013, EO will conduct examinations that will include a review of governance practices, both before and after the diversion event. We are hopeful that the exams will generate relevant information on how organizations can avoid these events, as well as help EO refine our indicators of potential noncompliance to better target our examinations resources.



# PLAIN LANGUAGE

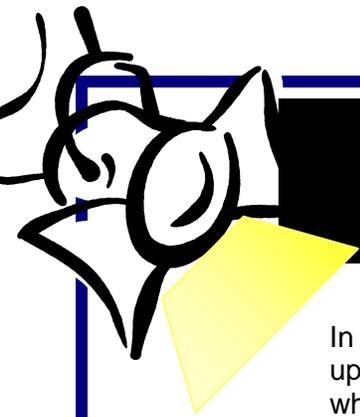
Exempt Organizations (EO) has joined the rest of the IRS in encouraging plain writing among its employees, not only to meet the requirements of plain language legislation passed by Congress, but because clear communications obviously are a win-win for tax-exempt organizations and the IRS alike.

EO Examinations led EO's efforts. Examinations' customer satisfaction surveys as well as input from employees cited the need for better communications, including written products, yet EO had no program in place.

Seeing this need as an opportunity, EO designed a plain-writing course that combines virtual instruction and interactive, personalized coaching and delivered it over the past year to a pilot group of 300 EO Examinations revenue agents around the country. The voluntary course proved to be so popular and helpful that it will be extended in FY 2013 to tax law specialists in Rulings and Agreements.

The course, called *Express Yourself*, is a back-to-basics refresher on fundamentals like avoiding wordiness, writing for the reader, using strong, active verbs, and being careful to observe the rules of grammar. A separate session focuses on more formal technical writing required of agents and other specialists, such as taxpayer correspondence, requests for documents and final reports. The course's core curriculum was recorded by the IRS's former Chief of Congressional Correspondence, an experienced trainer. During breaks between those segments, coaches from Appeals, Counsel, EO Rulings and Agreements, and EO Customer Education and Outreach summarize and discuss points and help participants understand how plain writing is relevant to their daily work. The coaches also review homework assignments in a series of separate online sessions.

In addition to *Express Yourself*, EO participates in an ongoing, IRS-wide plain-writing working group that is establishing standards and guides across the IRS.



# REVIEW OF OPERATIONS

In 2005, Exempt Organizations (EO) created the Review of Operations (ROO) to follow up on organizations after the IRS has approved them for exemption and determine whether they are complying with their tax requirements. These randomly selected follow-ups gave EO a less intrusive way to determine whether newly approved tax-exempt organizations — many of them start-ups — were engaged in activities that matched their stated tax-exempt purpose.

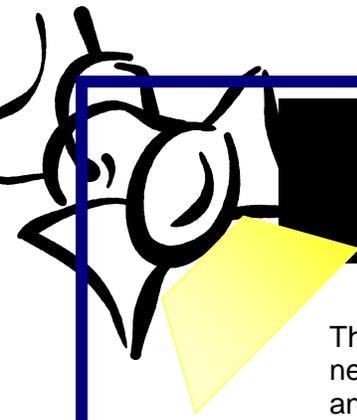
The ROO's efforts do not involve direct contact with the taxpayer. Decisions are based on the review of applications for exemption, other IRS information and information available from public sources, such as Internet searches.

In the ensuing years, the ROO has been a proven success, growing in scope and in the value it adds to EO's Determinations and Examinations work.

Among its expanded duties, the ROO:

- Follows up on organizations that were approved for exempt status by Determinations but that a specialist felt might bear another look in a year or two
- Checks to make sure an organization denied exempt status by the IRS is not holding itself out as exempt anyway
- Ensures that organizations are complying with the terms of closing agreements with the IRS
- Conducts specialized reviews that might focus on a particular issue or piece of legislation (such as community benefit reviews of hospitals under the Affordable Care Act)
- Uses its information-gathering abilities to greatly improve case selection for compliance projects and individual audits

Based on its success, the ROO has grown from an original staff of 14 to approximately 40 employees operating in two offices in Dallas and one in Atlanta. Together, they make Examinations and Determinations more effective and efficient and give meaning to a governing principle of IRS Exempt Organizations: trust, but verify.



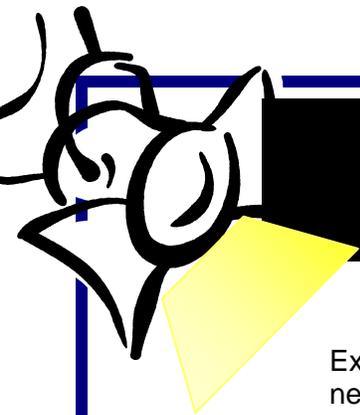
# AUTOMATIC REVOCATION AND REINSTATEMENT

The Pension Protection Act of 2006 (PPA) required small organizations, which had never before been required to file a return, to begin filing an annual notice with the IRS and also mandated that any organization—large or small—that failed to file a required return or notice for three consecutive years would lose its federal tax exemption by operation of law. As soon as the PPA was passed, EO began working to facilitate filing and prepare for the automatic revocations to come. Because the new law required small organizations to file an annual notice electronically, EO coordinated with other IRS offices to develop a new form, the 990-N, as well as an infrastructure for filing. Faced with the challenge of reaching hundreds of thousands of small organizations that had never before been required to file, EO engaged in an unprecedented effort to spread the word about the new filing requirements and the consequence of automatic revocation for failure to file for three consecutive years.

The PPA also required the IRS to publish and maintain a list of automatically revoked organizations. Since the list was first posted in mid-2011, EO has continued to respond to the challenges associated with automatic revocation and the needs of tax-exempt organizations and their stakeholders. Currently, more than 450,000 organizations have lost their exempt status, but only a little over 30,000 have come in for reinstatement. Because many revoked organizations are small and have limited resources, the IRS offered [transitional relief](#), including a reduced filing fee and automatic retroactive reinstatement, to qualifying organizations applying through December 31, 2012. Recently, the IRS extended the filing date for transitional relief until February 1, 2013, for [small automatically revoked organizations affected by Hurricane Sandy](#).

Of the more than 30,000 automatically revoked organizations that have submitted reinstatement applications to EO Determinations, some qualify for automatic retroactive reinstatement under the transitional relief. Others that seek retroactive reinstatement—that is, back to the date of revocation—must show reasonable cause for their failure to file in addition to providing other specified information.

EO continues to look for ways to better inform organizations and the public about automatic revocation and reinstatement. In January 2012, EO launched Exempt Organizations [Select Check](#), which is an on-line, one-stop search tool that allows users to select an exempt organization and find out whether it has been automatically revoked, is eligible to receive deductible contributions or has filed a Form 990-N (e-Postcard) annual electronic notice. In March 2013, EO will begin providing more current information about automatic revocations by including organizations on the Automatic Revocation List within a month of their effective date of revocation. Previously, organizations did not appear on the List until six months after revocation. Because of this change, the number of organizations added to the List in March, 2013, will appear higher than in other months because it includes a catch-up period of about seven months.



# DETERMINATIONS

Exempt Organizations (EO) Determinations consistently receives approximately 60,000 new applications for exemption every year. As the complexity of the applications and concerns about potential abuse have increased over the last several years, EO Determinations has implemented a number of improvements to the application process. Rather than assigning all cases to a revenue agent for development, we put in place a screening system to fast track applications that are substantially complete and require little or no further development. Technical screening is conducted as a first step in all cases by EO Determinations' most experienced revenue agents who review the applications and separate them into four categories:

- Substantially complete applications that do not require additional information (determination letter usually received within approximately 90 days)
- Applications that are not substantially complete (letter advising that the case was closed without action usually received within approximately 60 days)
- Applications where minor additional information is needed (request for additional information usually received within approximately 120 days)
- Applications that must be assigned to an agent for further development to determine whether requirements for tax-exempt status are met ("full development")

In FY 2012, 70 percent of all application cases were reviewed and closed within approximately 120 days during technical screening (i.e., cases in the first three categories above). Applications that cannot be completed through technical screening are sent to unassigned inventory, where they are held pending availability of a revenue agent with the appropriate grade level and experience for the issues involved in the matter. Certain applications, including cases where issues cannot be resolved by established precedent and thus require interpretation of the tax law, are reserved to be handled by EO Technical in Washington, DC. Those applications often take longer to process given the novel and complex issues involved.

In order to give applicants a sense of how long the wait could be before their application is assigned to a reviewer, we post on our website the submission date of full development [applications currently being assigned](#). This date only applies to full development applications. In an abundance of caution, the date given on the website is the date of the oldest application awaiting assignment. Most applications requiring full development are assigned well before that date. The average wait time for full development applications at this time is roughly five months from the date we receive the application. We know the web page has created some confusion, so we are in the process of revising both the webpage and letters to applicants to provide better information on wait times.

EO Determinations understands the importance of processing exemption applications quickly, accurately, and consistently. We are continually refining the determinations process to better achieve these goals.

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# FY 2013 WORKPLAN

*This workplan highlights where Exempt Organizations (EO) is deploying resources in FY 2013. These projects are in addition to our day-to-day determinations and examinations responsibilities.*

*As stated in the Letter From the Director, EO plans to deliver timely information about ongoing projects, as well as updates on projects when they start or close. This year, we present the FY 2013 Workplan in two main categories:*

- *Completed projects*
- *Ongoing projects*

*We hope that this organization of our workplan highlights the status of each project and helps keep the tax-exempt community better informed about our efforts.*

## **I. COMPLETED PROJECTS**

*As we mentioned in our [FY 2011 Workplan](#), when projects conclude, we incorporate the applicable processes and procedures they generated into our day-to-day work.*

### **Public Charity Status**

In 2008, the IRS eliminated the advance ruling process for organizations seeking tax-exempt status as publicly supported charities. Under an advance ruling, a § 501(c)(3) organization received public charity status for a five-year period but then had to file Form 8734, *Support Schedule for Advance Ruling Period*, to demonstrate that it had met the public support test. With the elimination of the advance ruling period, organizations no longer have to file this separate “look back” report, and the IRS monitors an organization’s public charity status after the first five years based on the public support data reported on Schedule A of Form 990.

Some organizations were still in their advance ruling period when the process was eliminated. The IRS looked at a statistically valid sample of the Schedules A filed by 400 of these organizations to determine whether they had properly computed their public support percentage. These compliance reviews showed that a high percentage of organizations reported correctly on Schedule A. EO will continue to monitor § 501(c)(3) organizations’ qualification for public charity status as part of its regular, on-going assessment of Form 990 data.

### **Intermittent Non-Fileers**

In FY 2012, as one piece of our comprehensive non-filer program, EO completed compliance checks on about 240 organizations that had not filed a Form 990 or 990-EZ for tax year 2009. These organizations had filed for prior years, so we inquired about the failure to file.

These contacts resulted in submission of over 230 delinquent Form 990 or 990-EZ returns. We also found that a small number of contacted organizations had filed correctly, but their returns had not been fully processed prior to the mailing of the compliance contact letters.

In FY 2012, EO started an additional 300 compliance checks on non-filers for tax year 2010, as this effort has now become a part of our regular work.

## **Community Foundations**

Community foundations began as a small group of charitable trusts established at local banks or trust companies to benefit residents through scholarship or other similar grantmaking programs. Over the past decade, there has been a significant increase in the number, size and complexity of community foundations and their grantmaking and other operations, including in some cases, related donor-advised funds.

EO sent [questionnaires](#) to approximately 3,700 organizations asking for information on their demographics, revenues, assets, investments, grantmaking and relationships. Over 3,500 organizations responded. Based on questionnaire responses and other research such as reviews of websites, EO corrected Master File community foundation designations for about 800 organizations.

Using questionnaire responses and information on the Form 990, EO selected certain community foundations for examination. The IRS was particularly interested in those organizations where donors appeared to exercise significant control over investment and grantmaking decisions. Although most of the examined organizations satisfied the regulations governing community foundations, the IRS found that some were potentially mischaracterizing fees earned from providing administrative, clerical, or grant-related services to unrelated organizations as related income.

### **“Mutual” Organizations Exempt under § 501(c)(12)**

Organizations exempt under § 501(c)(12) include benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, or cooperative telephone companies. These organizations must collect at least 85 percent of their income from members for the sole purpose of meeting losses and expenses, with any excess being returned to members or retained for future losses and expenses. The results of the member-income "test" determine the organization's yearly filing requirement: Form 990 for the years in which it meets the 85 percent member-income test (income is tax-exempt), Form 1120 for the years it does not (income is taxable).

Based on Form 990-reported membership income percentages, EO sent compliance check questionnaires to a group of § 501(c)(12) organizations. Using the questionnaire responses and filed Form 990 information, EO selected about half of these organizations for examinations, all of which are now complete.

One-fourth of the examined organizations either failed the member-income test or were not being operated as a mutual entity or cooperative. EO procured the required tax forms or proposed revocation of exempt status as appropriate.

EO agents found that some of the other organizations had miscalculated and misreported their membership income percentages. In light of the high level of incorrect reporting, EO Customer Education and Outreach will work with IRS Forms and Publications to provide additional education on proper § 501(c)(12) membership income reporting in FY 2013.

## EO Examinations Resource Pages on IRS.gov

In response to taxpayer requests for readily available information about the EO examination process, EO Examinations worked closely with Customer Education and Outreach in FY 2012 to centralize information about the examination process on IRS.gov. [These new pages](#) provide updated information to help familiarize organizations with what they need to know to help them prepare for an audit. Many of the pages have been simplified to make the reader's experience easier and clearer. At-your-fingertips information now includes:

- Many reasons an organization might be selected for review
- The distinctions among various types of review, including field audits, correspondence audits and non-audits, such as compliance checks
- What to expect during an examination, from initial contact to closing letter
- Taxpayer rights, including appeals
- Fast Track Settlement, a quicker way to resolve disputes

Several pages also have new links to additional information for ease of navigation.

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## II. ONGOING WORK

*This section includes the status of projects started in previous years and, where possible, findings to date.*

### **§ 512(b)(13) Study**

The Pension Protection Act of 2006 (PPA) made numerous changes to the provisions of the Internal Revenue Code affecting exempt organizations. The § 512(b)(13) study is in response to a provision of the PPA that amended the law with respect to the unrelated business taxable income of an exempt organization and payments received from controlled entities. The provision also directed the Secretary of the Treasury to report on the administration of the new statute and to provide recommendations related to the tax treatment of payments between controlled entries and their parent exempt organizations. The Department of the Treasury asked EO to draft the report.

To gather basic data, we developed a § 512(b)(13) checksheet to be used in examinations. During the last two years, EO revenue agents completed about 3,000 checksheets, and we have now begun to analyze them.

### **National Research Program (NRP)**

FY 2013 is the third and final year of this IRS-wide research project on employment tax compliance.

EO revenue agents have examined employment tax forms filed by exempt organizations for the tax years 2008, 2009 and 2010. To date, the agents have closed approximately 6,500 returns from almost 2,000 organizations and individuals. In FY 2013, EO will complete approximately 2,500 remaining returns and provide the data to the IRS-wide NRP project for further processing.

## International Activities of Charities

EO is interested in ensuring that assets and income of domestic charities are not diverted to non-charitable purposes when the funds are sent abroad, as well as whether U.S. charities comply with regulations on recordkeeping and reporting when they operate or donate funds overseas.

In FY 2012, EO completed examinations of a sample of organizations that reported a foreign bank account on their Form 990s.

The results of the exams showed four problem areas:

- Failure to file the required [Report of Foreign Bank and Financial Accounts](#) (FBARs)
- Inadequate recordkeeping
- Lack of discretion and control over funds sent abroad
- Failure to file employment tax returns (or filing incorrect returns)

In FY 2013, we will shift our focus to examinations of organizations with high amounts of foreign grant expenditures.

This past year, EO also continued a project to determine levels of tax compliance by large private foundations, based on assets and revenues, with both § 501(c)(3) requirements and the specialized rules for private foundations. Many of the selected entities had foreign investments or made grants overseas.

About half of the examinations closed to date resulted in additional taxes or penalties. Adjustments to date included:

- Excise taxes on net investment income
- Taxes on unrelated business income
- Taxes on certain expenditures that are taxable when made by private foundations
- Employment taxes

In FY 2013, EO will complete examination of the remaining returns.

Finally, EO continued examinations of charities that participate in “Gifts-in-Kind” programs in which charities send non-cash items to other domestic or foreign organizations. In conducting these examinations, EO has coordinated with foreign regulators regarding organizations under their jurisdiction.

EO revoked the § 501(c)(3) exempt status of two organizations due to excessive private benefit and insufficient charitable activity. In other cases, EO noted the following problem areas:

- Poor recordkeeping of the gifts-in-kind
- Inaccurate reporting of this activity on Forms 990
- Inadequate discretion and control over the final disposition of the items

EO expects the remainder of the open cases in this project to close in late FY 2013. Additionally, more cases are being reviewed for potential examinations, with specific emphasis on organizations with limited charitable activity and excessive compensation.

## **State-Sponsored Workers Compensation Organizations**

EO reviewed the activities of a number of state-sponsored groups that provide workers compensation insurance and claim tax-exempt status under § 501(c)(27). Together with TE/GE Research and the Government Entities division, we developed a questionnaire and sent it to approximately 40 organizations to determine whether they are meeting the criteria for exemption, are correctly classified as exempt, and are paying any employment taxes due. Based on our review of questionnaire responses, EO will refer some organizations to Government Entities, Large Business and International, or Small Business/Self Employed divisions for examination.

## **Group Rulings**

In FY 2012, EO developed the [Group Rulings Questionnaire](#) for completion by a broad cross-section of central organizations holding group rulings. The impetus for this questionnaire was the [2011 report on group exemptions by the Advisory Committee to TE/GE \(ACT\)](#), together with the large number of subordinates whose exemption was automatically revoked for failing to file a Form 990-series return for three consecutive years. EO hopes to learn about the relationship between central organizations and their subordinates and the ways in which central organizations and their subordinates satisfy their filing requirements.

In early FY 2013, EO mailed the comprehensive questionnaire to over 2,000 randomly selected central organizations. Recipients of the questionnaire are able to complete and submit responses online. EO anticipates that this new online system will shorten and improve the experience for respondents, as well as speed up data collection and analysis. EO also updated the IRS website with [new information links about group rulings](#) and a [reference copy of the questionnaire](#).

## **Mortgage Foreclosure Assistance**

In FY 2012, EO began a project focusing on organizations that offer or propose to offer foreclosure assistance activities. As mortgage foreclosures have risen over the past several years, EO has seen an increase in the number of organizations that claim to help individuals facing foreclosure. However, the activities of many of these organizations closely resemble those that EO looked at several years ago — noncompliant organizations that claimed to offer credit counseling support.

EO reviewed approximately 115 exemption applications from new organizations planning to offer mortgage foreclosure assistance programs. In follow-up letters, EO asked these organizations to show specifically how their proposed activities would meet § 501(c)(3) requirements.

Almost half of the applicants either did not respond to EO's questions or withdrew their applications after receiving EO's inquiries. About one-third of the applicants responded to the questions, met the requirements and were approved.

EO proposed or finalized denial of recognition of exemption for some applicants because their proposed activities either:

- Were not charitable
- Were commercial in nature
- Provided financial benefits to related businesses
- Appeared to attempt to take advantage of homeowners

In addition to reviewing applications, EO has also identified about 280 existing exempt organizations that appear to be providing mortgage foreclosure services. In FY 2013, we will conduct compliance reviews of these organizations and, where appropriate, recommend examinations.

### **Form 990-N Misfilers**

The Pension Protection Act of 2006 (PPA) significantly impacted exempt organizations' annual reporting in two ways. First, it required most small exempt organizations to begin filing Form 990-N, the *e-Postcard*. Second, it mandated automatic revocation of exempt status of any organization failing to meet its annual filing requirement for three consecutive years.

Once the Form 990-N filing system was up and running, EO began monitoring to make sure that only eligible organizations were using it. Since filing began in 2008, we have determined that:

- Several hundred organizations submitted Form 990-N for tax years where other available information indicates they did not meet the Form 990-N filing criteria because they were too large.
- Several hundred apparent supporting organizations filed Form 990-N even though PPA required most such entities to file a Form 990 or 990-EZ.
- Over 1,000 organizations “dual-filed” both Form 990-N and another Form 990-series return for the same tax year.

We conducted compliance checks with the first two groups to obtain further detail on their eligibility to file Form 990-N. Over 200 organizations who filed the Form 990-N also provided information to the IRS indicating they were not eligible to file that form. In this circumstance the returns were not treated as valid filings and therefore, they will be notified that they automatically lost their exempt status, as mandated by law. Another 200 organizations did not provide sufficient information in their compliance check responses to make a determination that they have correctly filed. We will examine these organizations in FY 2013 and will contact the “dual-filing” organizations to determine their future filing requirements.

### **§ 501(c)(4),(5) & (6) “Self Declarers”**

In FY 2012, EO developed a project focusing on § 501(c)(4),(5) & (6) organizations. These entities, which include social welfare organizations; labor, agricultural and horticultural groups; and trade associations, can declare themselves tax-exempt without seeking a determination from the IRS. EO wants to learn more about whether such organizations have classified themselves correctly and are complying with applicable rules.

In FY 2013, EO will send a questionnaire to organizations that “self-declared” by filing Form 990 for tax year 2010 or 2011. As in the Group Rulings questionnaire, recipients will be asked to complete the questionnaire online and submit it electronically. EO will analyze the responses and determine next steps.

### **Colleges and Universities**

During FY 2012, EO completed a significant number of examinations in this project, and has begun to draft a final report. In FY 2013, EO will complete the report, which will include results from the examinations as well as additional analysis of the data from questionnaire responses previously received from almost 400 institutions.

## **EO Services and Assistance (EOSA)**

EO launched the EOSA research project to better understand how small tax-exempt organizations receive tax-related information. The IRS started the project by gathering information from these organizations through a series of focus groups and a telephone survey. Drawing on what we have learned from the focus groups and surveys, EO is considering the most cost-effective ways to tailor its outreach efforts to meet the needs of these small organizations. In FY 2013, EO will develop communications materials and methods to implement the lessons learned.

## **Using Form 990 Information in Compliance Efforts**

In 2008, the IRS released a new version of the Form 990 designed to promote transparency and improve compliance. The form requires filing organizations to supply more in-depth information than previous versions. We are using this information to develop potential indicators of noncompliance for use in our examination process. Once developed, these potential indicators must be tested, and we are in the early stages of that process.

As we examine organizations selected through this data-driven approach, we find that the Form 990 responses of some organizations do not always accurately reflect their activities. If those organizations had been more careful in completing their returns, they might not have been identified by our indicators or selected for examination. Because of the new ways we are analyzing return data and selecting cases, it is more important than ever that organizations follow instructions, compute properly and report accurately on their Forms 990. The bottom-line message to organizations and practitioners alike: The IRS uses the Form 990 responses to select returns for examination, so a complete and accurate return is in your best interest.

The following are compliance projects worked in FY 2012 that drew on data from the Form 990 and tested the indicators of potential noncompliance.

### **- Charitable Spending Initiative**

In this long-range study, EO is using data from filed Forms 990 to focus on the sources and uses of funds in the charitable sector and their relationship to charitable accomplishments. We selected for examination a group of about 170 small organizations reporting high expenses in certain categories on their Forms 990 — for example, relatively large fund-raising amounts when compared with the expenditures for the organization's charitable programs.

Some of the results of this project illustrate the inaccurate Form 990 reporting noted earlier. In about one-third of the completed examinations, the reported high expense ratios turned out to be lower after examiners completed a full review of books and records.

More than 150 examinations have been completed and the remainder will close in early FY 2013. EO revoked the exempt status of four organizations due to either very little (or no) charitable activity or inurement to an officer. In other cases closed so far, EO has assessed tax on the unrelated business income of three organizations and secured or adjusted close to 100 employment tax returns.

In FY 2013, EO will use lessons learned during the exams of small organizations as well as similar criteria to identify a group of medium to large organizations to examine. We also will focus on organizations reporting substantial income from fundraising, but little or no fundraising expenses.

## **- Compensation Transparency**

In this new approach to our ongoing interest in compensation, EO has focused on organizations reporting high annual gross receipts with very low total compensation to all officers, directors, trustees and key employees. EO's concern is whether some organizations may be circumventing the goal of transparency by hiding compensation levels.

The EO Review of Operations (ROO), using the Internet and internal sources, gathered information on a random sample of 200 organizations — a mix of “stand-alone” organizations and those reporting a formal relationship with one or more related organizations. Examinations will begin in FY 2013.

## **- Political Activity**

In FY 2012, EO combined what it had learned from past projects on political activities with new information gleaned from the redesigned Form 990. Using the Form 990 data, EO developed indicators of potential noncompliance that allow us to better focus our resources. These indicators are now being tested and applied along two tracks:

- Based on current Form 990 data, the potential indicators of noncompliance have been used to identify organizations engaging in possible impermissible campaign intervention. Thus far, we have identified approximately 300 cases. This information, along with any other relevant public information, is sent to a committee of career civil servants for evaluation. Based on its review, the committee determines whether an examination of a particular organization is warranted.
- When EO receives referrals from outside sources alleging political campaign intervention, that information is also evaluated by a committee of career civil servants. After review, this group selects the cases that will be referred for examination. We also test the referral against our indicators of potential noncompliance as a way to refine and improve our criteria.

In FY 2013, EO will continue to work on cases that come through these two tracks. In addition, as a regular part of our political activity review, we will determine whether organizations are required to file Form 1120-POL under § 527(f), and if so, whether they have filed. We will use the results of the reviews, as well as other data analytics, to further refine our indicators of potential noncompliance.

## **- Form 990-T and Unrelated Business Income (UBI)**

In FY 2012, EO completed compliance checks of 400 organizations that had reported taxable UBI activities on their Forms 990 but had not filed Form 990-T, *Exempt Organization Business Income Tax Return*. This work resulted in EO securing about 140 delinquent returns and more than \$260,000 in tax payments.

In about one-quarter of the cases, inaccurate reporting on their returns resulted in organizations being examined for UBI issues. Examiners determined that if the organizations had reported correctly, they would not have been examined.

In FY 2013, EO will examine a statistically valid sample of organizations reporting substantial gross UBI for three consecutive tax years, but reporting no income tax due for

any of those years. EO's concern is whether these organizations are accurately reporting their sources of UBI and correctly allocating and deducting expenses associated with it.

### **Interactive Form 1023**

In its [2012 report](#), the ACT recommended that the IRS move towards an interactive, electronically-filed Form 1023, *Application for Recognition of Exemption*. As an interim step towards this recommendation, as well as a response to stakeholder and employee feedback, EO is developing an interactive, educational version of the Form 1023.

The interactive Form 1023 will feature pop-up text boxes for each line of the form that provide instructions and relevant links to online information at IRS.gov and [StayExempt.irs.gov](#). EO hopes that this form will help § 501(c)(3) applicants file a complete and accurate application for exemption and improve the quality and consistency of exemption applications. EO plans to make this product available to the public in FY 2013.

### **Referral Selection Research Project**

One way EO has traditionally identified organizations for examination is through [referrals](#). Referrals are allegations of potential tax law violations that come from the public, Congress, other government agencies and also from within the IRS. Each referral that comes to EO is first routed to an experienced agent for preliminary research. In some cases, the agent then determines whether the referral has identified a potential violation of tax law and an examination is warranted. For certain issues, EO has established committees of experienced agents to consider whether referred organizations should be examined. If a referral raises one of those issues, the agent sends the referral on to the appropriate committee for consideration.

Because referred organizations constitute just one part of the EO Examinations workload, they must be balanced against other examination priorities. With referral cases, as in other parts of its work, EO has been developing tools using Form 990 data to facilitate more effective use of resources. In FY13, EO will begin a project testing the impact of using Form 990 data analytics to prioritize assignment of referral cases selected for examination. Based on the results, EO will continue to refine its selection of referred organizations for examination.