

**TESTIMONY OF STEVEN T. MILLER  
COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION  
INTERNAL REVENUE SERVICE  
BEFORE THE  
OVERSIGHT SUBCOMMITTEE  
HOUSE WAYS AND MEANS COMMITTEE  
ON THE OVERSIGHT OF TAX-EXEMPT ORGANIZATIONS**

**JULY 24, 2007**

Good morning Chairman Lewis, Ranking Member Ramstad, and Members of the Oversight Subcommittee. Thank you for the opportunity to appear this morning. My name is Steven Miller and I am the Commissioner of the Tax Exempt and Government Entities (TE/GE) division of the Internal Revenue Service (IRS).

TE/GE is one of four operating divisions created after the enactment of the IRS Restructuring and Reorganization Act of 1998 (RRA). Each division is dedicated to a specific group of taxpayers. TE/GE's three major business units – Exempt Organizations (EO), Employee Plans (EP), and Government Entities (GE) – oversee a wide range of activities affecting taxpayers from small volunteer community organizations to large private foundations; from villages to sovereign Indian tribes, from IRAs to large pension funds, as well as an ever-increasing variety of tax-exempt bonds.

In accordance with the wishes of the Subcommittee, my testimony this morning will offer an overview of the tax-exempt community, specifically 501(c)(3) organizations, our role in regulating that community, and some of our initiatives and challenges.

I am a tax administrator, and what I will say today may seem to overstate the presence of compliance problems within the charitable sector. There is no question that such problems do exist, but let me start with two observations. First, the charitable sector deserves to be commended for the vital work it does throughout America, and indeed throughout the world. Second, on the whole, the charitable sector is very compliant with the Tax Code. While we have seen problems, some of them serious, and some of them involving major charitable institutions, they are not widespread. We are working to keep it that way. We believe that through our efforts and those of the leadership of the charitable sector, we are ensuring that problems do not overwhelm the good that charities do. Credit for this should be shared with this Committee as well, and with the Congress as a whole. We appreciate your interest, action, and oversight.

## **Role of Charities in American Society**

### **In General**

Charities and other tax-exempt entities have always played an important role in the fabric of American life. Tax-exempt organizations meet critical needs in American society. They feed the hungry, shelter the homeless, and care for the elderly. They operate schools, universities, and hospitals. They are our churches. They conduct research that saves lives and provides for a better standard of living. They serve as the backbone of our cultural and artistic life. They preserve our history and our historic buildings; they operate museums, and they engage the desire of Americans to give something back to their communities by offering a vast array of opportunities for volunteer work. In times of crisis, such as the aftermath of September 11 or Hurricane Katrina, the importance of their work is visible for all to see.

Charities and volunteer organizations seem to represent something enduring about Americans. In our history books, we read the story of the creation of such iconic charities as Clara Barton's American Red Cross and Jane Addams' Hull House. Just last year, contributors gave more to charity than ever before. Across the centuries, the charitable impulse has been strong within our country.

The Congress has recognized charities' important role by enacting and preserving section 501 of the Internal Revenue Code, which creates the tax-exemption that charities and other tax-exempt organizations enjoy. The large annual tax-expenditure for tax-exempt organizations represents a strong endorsement by Congress of the work of the charitable community.

### **Demographics of the Tax-Exempt Community**

The tax-exempt sector, which includes more than section 501(c)(3) charities, has been growing rapidly. Since 1997, the number of tax-exempt organizations on the IRS master-file increased by more than 350,000. The total number now approaches 1.6 million, a figure that does not include most churches. These organizations hold assets in excess of \$3 trillion.

Internal Revenue Code section 501(c)(3) describes a subset of the entire tax-exempt sector. Section 501(c)(3) organizations include those organized and operated exclusively for religious, charitable, scientific, educational, and other specified exempt purposes. They are eligible to receive tax-deductible contributions and are subject to certain operating restrictions.

Currently, more than one million tax-exempt organizations are classified as section 501(c)(3) organizations. This includes private charities and private foundations, but not churches, which generally have no filing requirement. Section 501(c)(3) organizations hold assets in excess of \$2.5 trillion (private

charities hold \$2 trillion; private foundations \$500 billion). Public charities have annual revenues of nearly \$1.16 trillion, and spend approximately \$900 billion per year on program services. Private foundations have annual revenues of \$68 billion.

### **Current External Environment for Charities**

Like any vibrant sector of our economy, the charitable sector is changing. We have witnessed continued growth in this sector, both in terms of its sheer size and in terms of its complexity. Most 501(c)(3) organizations are created and run by volunteers and typically have a staff of fewer than ten employees. However, increasingly, many 501(c)(3) organizations are becoming large economic hubs (e.g., hospitals, universities, and foundations). Some are enormous, control great wealth, and operate on a global scale. With size may come complex organizational structures and the ability to participate in cutting edge economic transactions.

As the parents of the baby boom generation begin to pass away, and as the baby boomers themselves near retirement, we expect to see a significant transfer of wealth from one generation to another and the contribution of large sums to charities. With this transfer of wealth comes intensified financial and tax planning resulting in the creation of new, and sometimes troubling, gift and planning devices.

The Internet also has an effect on this environment. Its obvious influences include its revolutionary contributions to communications and the possibility of almost real-time transparency. It also raises issues concerning web-based fundraising and virtual charities. Moreover, the Internet may blur the concept and importance of state and national borders, with implications for local jurisdiction over local charities.

### **The Regulatory Environment for Charities**

The tax-exempt sector has changed markedly over the past 40 years, but there has been much less change in the laws governing tax-exempt organizations. In recent years, however, legislative interest in this area has picked up. Congress has passed the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) and the Pension Protection Act of 2006 (PPA), two important pieces of legislation that address a host of issues in the tax-exempt sector. While it is too early to measure specific results, the legislation has given us additional tools.

In the early years of this decade, we began to be concerned with whether we were maintaining a sufficient enforcement presence in this area. It is clear that we need to be “on the beat,” and to be perceived as such. Voluntary compliance is clearly influenced by the IRS’ enforcement capacity and presence. As we will

discuss later, under former Commissioner Everson's leadership, we improved our enforcement program.

The President's 2008 budget for the IRS will advance our efforts, and I respectfully request your support for it. This budget supports our continued emphasis on compliance in the tax-exempt area. For FY 2008, the Administration has requested a 6.3 percent increase in the IRS budget. The budget includes a larger increase for TE/GE (10.8 percent or \$26.4 million), with a 12.3 percent increase for our examination program and a 12.6 percent increase for our determinations program.

### **Role of the Internal Revenue Service**

Congress has established in the tax law certain limitations on what those granted the privilege of tax exemption may do. Tax exemption is granted only for certain defined categories of activity. Those who wish exemption from tax must act within those limitations. This is the cost of tax exemption -- the conditions that must be met to receive the tax subsidies granted by Congress.

The Internal Revenue Service has a balanced program for regulating the charitable sector. Within the IRS, TE/GE has the responsibility to administer and enforce these limits. Doing so accomplishes a number of important public purposes. First, it insures that Congressional intent is honored. Second, it helps maintain public confidence in the integrity of the charitable sector. And third, it prevents the erosion of the tax base by ensuring that those who would prey upon innocent contributors or misuse the privilege of tax exempt status are identified and stopped from doing so.

The Internal Revenue Service approaches this responsibility with a balanced program that emphasizes both service and enforcement. The program is carried out by the 860 members of TE/GE's Exempt Organizations function. TE/GE's efforts in this area may be best described as falling into three categories: determinations or rulings on prospective matters, education and outreach, and a vigilant examination program.

TE/GE's determination program for applicants for exempt status is particularly important. In this program, prospective exempt organizations submit information to the IRS about their purpose and structure. Determination specialists review the applications and, where necessary, work individually with the applicant to insure that the organization meets the requirements of the Code for tax exemption. Unless the organization is later selected for examination, the determination process is often the only time the IRS is in direct contact with the organization.

The determination process therefore represents an important opportunity for the IRS. It is the time when the IRS has the chance to ensure that the charity is

organized as required, that the organization is operating properly, and that the IRS has the information it needs about the organization. The determination letter process also presents an important educational opportunity for the applicant to learn of its responsibilities and filing obligations as an exempt organization.

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We have addressed this situation. I am happy to report that we have made good progress in reducing the backlog and improving timeliness. We are continuing this effort.

TE/GE augments the determination process with an active education and outreach program for the charitable sector. In FY 2006, for example, this program included presentations at the 12 IRS Nationwide Tax Forums of exempt organization seminars to 8,120 participants; 18 one day-long workshops in six cities with 2,153 participants, and three hour-long phone forums with 1,100 participants. Since 2005, EO has published an electronic newsletter, "EO Update." It has 20,360 current subscribers and we have published 54 issues. The IRS also maintains a TE/GE toll-free call site where individual questions are taken and answered.

The overarching purpose of the education and outreach process is to keep existing exempt organizations compliant by keeping them alert to the requirements of the law and by giving them the opportunity to have their questions answered. One particularly helpful tool is our extensive web site, which includes web-based information tools called "Life Cycles." Each Life Cycle provides practical information about each of five stages organizations typically go through during their existence: starting the organization; applying for tax-exempt status; filing required returns and other documents; maintaining the organization; and terminating the organization. We provide Life Cycles for public charities, private foundations, social welfare organizations, labor organizations, agricultural and horticultural organizations such as farm bureaus, and trade associations and other business leagues. Another tool we offer is StayExempt.org, a web-based version of the day-long workshop for small and mid-size exempt organizations.

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While we provide an upfront evaluation of a charity's exempt status and support exempt organizations with customer education and outreach, we also must have

a process to review these organizations as they operate. We therefore maintain a robust examination program. We have made major changes in the way we examine organizations in the last few years, adding staff and offices that allow us to respond flexibly to different types of non-compliance in different areas. We are constantly looking for more efficient and effective ways to conduct examinations.

The examination program is aimed at detecting and deterring non-compliant behavior. We have strengthened this program in a number of ways over the past several years, including shifting resources into it. In FY 2003, we had 394 examination FTE and performed 5,754 examinations. By FY 2006, we increased examination FTE to 507 and examined 7,079 returns, an increase of 23 percent from 2003, and the highest level since FY 2000. In addition, we have created new offices and engineered new business processes that broaden and strengthen our compliance presence. These include the Exempt Organization Compliance Unit (EOCU), the Data Analysis Unit (DAU), and the EO Financial Investigations Unit (FIU).

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### **Areas of Concern within the Charitable Sector**

As we have stated, when people make contributions to charities, they expect that their contributions will be used to accomplish a charitable purpose. If the charity uses the contribution for the personal benefit of executives, or misuses it in some other way, the credibility of the recipient charity and other charities is called into question, and Congressional intent in granting the tax exemption is thwarted.

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That is why it is important for IRS to act as the “cop on the beat” to insure that charities behave in accordance with their charter and the privilege of tax exemption.

We now turn to a description of some areas in which we have specific concerns about compliance and possible abuse of the privilege of tax-exempt status. We have grouped these concerns into five areas.

**1. Charitable Contribution Overvaluation:** Charitable contributions raise a number of compliance concerns. One involves improper valuation of non-cash donations, an issue that occurs in many contexts in the tax-exempt area. Additional concerns are whether a donor receives some form of consideration in exchange for a contribution, and whether a donor transfers only a partial interest in the contributed item.

While recent legislation provided some much-needed assistance on the issue of proper valuation of non-cash donations, we anticipate that overvaluation will continue to be a significant problem in charitable contributions of property. These issues are often difficult. Overvaluations may arise from taxpayer or appraiser error, from aggressive taxpayer or appraiser positions, or from fraud or other deliberate behavior. Valuation problems are greatest with non-cash charitable contributions for which no ready market exists, and the failure to substantiate properly the value of such contributions exacerbates the issue. Although the problem manifests itself in various contexts, the underlying issue is the same. Cases are often difficult, because of the need for experts and because the costs to audit, appraise, and litigate generally are high and sometimes may exceed the recovery. Nonetheless, we continue to pursue this issue through a variety of compliance programs.

**2. Charities Established to Benefit the Donor:** This group of compliance issues shares a common feature: a donor claims a deduction for a charitable contribution while maintaining control over the contributed assets, and often uses them for personal benefit. The IRS is actively conducting examinations in all these areas, including areas such as charitable trusts. Congress acted recently with respect to the two areas described below. The IRS is implementing these changes, but it is too early to determine with any specificity their full impact.

- **Abusive Donor-Advised Fund Arrangements.** A donor-advised fund is a separate fund or account maintained by a public charity to receive tax-deductible contributions from a single donor or a group of donors, with the donor retaining the right to advise with respect to the use or investment of the account. In our examination program, we found that certain promoters encourage individuals to establish purported donor-advised funds used for a taxpayer’s personal benefit. We also found that some of the charities that sponsor these funds may be complicit in the abuse.

**Section 509(a)(3) Supporting Organizations Established to Provide Benefits to Founders.** Supporting organizations are public charities that, in carrying out their exempt purposes, support one or more other exempt organizations, usually other public charities. Most problems we find with supporting organizations are in the so-called Type III organizations, where the relationship between the supporting and the supported organizations is least formalized. We also have found issues with Type I organizations, where a promoter may control the supported organization. Other problems include *quid pro quo* issues with money either never actually being donated or, if donated, being returned as loans or other forms of inurement, and problems with the promotion of these transactions.

### **3. A blurring of the line between the tax-exempt and commercial sectors.**

As the tax-exempt sector grows larger, wealthier, and structurally more complex, the line between charities and the commercial sector blurs as businesses try to act like charities in order to reap the benefits of tax exemption and as charities engage in business-like activities in order to raise funds for their activities. As charities themselves begin to engage in complex deals, they run the risk of violating the limitations that apply to them. Concerns exist in this area in a variety of contexts:

- **Commercial Operators Moving into the Charitable Sector.** The movement of commercial enterprise into the charitable sector remains an issue. Various factors encourage this movement, including the absence of bright line standards in the tax-exempt area, the promise of exemption from consumer protection and similar Federal and state regulatory statutes often enjoyed by charities, and the economic benefit the tax exemption itself conveys. The line between commercial and charitable operations may be further blurred in certain cases where market forces, industry practice, or the non-tax regulatory environment has changed over time. Specific examples follow:
  - **Credit Counseling.** Credit counseling is a clear and disturbing example of how commercial operators seized upon lawful tax-exempt activity and converted it into something entirely different and decidedly commercial. These operators never relinquished their claim to tax-exemption and took advantage of regulatory exceptions to operate without restriction in an otherwise highly regulated market. We conducted a vigorous examination program of the entire credit counseling industry and thus far have proposed revocation or revoked the tax-exempt status of 41 percent of the industry, as measured by gross receipts. Approvals of applications for determination letters for new credit counseling organizations have come virtually to a halt. The Congress also acted, and we believe that this action has significantly reduced the abuse and the movement of commercial operators into this area.

- **Down Payment Assistance Organizations.** Down payment assistance organizations can perform a valuable role in helping low-income individuals become home owners. However, promoters have set up “charities” that allegedly aid people who need help to make a down payment for a home. In the abusive cases, these organizations operate for the benefit of the seller and the mortgage lender, often at the expense of the buyer who assumes responsibility for mortgage payments beyond his or her means. Again, these organizations took advantage of favorable non-tax regulations intended to be available only to true charities, and instead provided an impermissible private benefit. We issued Revenue Ruling 2006-27 in 2006 to provide clear guidance on the subject of down payment assistance. Although we are working vigorously in this area, it remains a current compliance challenge.
- **Complexity and Administrative Difficulty of Unrelated Business Taxable Income Determinations (UBTI).** A problem exists with UBTI in situations where drawing lines between “related” and “unrelated” activities and uncertainty about allocating expenses (including indirect expenses) and income between related and unrelated economic activity allows excess flexibility. This problem is becoming more critical as tax-exempt entities provide goods or services that are similar to, or in some cases virtually indistinguishable from those offered by the taxpaying commercial sector. This movement raises a number of concerns, including the erosion of the nation’s tax base, unfair competition with the commercial sector, and potential damage to the public’s support of the charitable sector.

This is not to say that an organization that engages in activities that have commercial analogues cannot be tax-exempt, or that the income generated is necessarily UBTI. However, we cannot overlook the compliance issues that these and similar activities raise, or ignore the difficult administrative problems they create for the IRS. As commercial and investment activity proliferates, we must determine how much activity or funding exempt organizations are dedicating to charitable purposes.

Another issue involves the number of organizations reporting losses on the Form 990T. According to recent data, approximately 50 percent of Form 990T filers report zero income or a loss in the conduct of their unrelated business activities. Beginning in 2008, we will explore the treatment and allocation of income and expenses in university systems.

**4. Executive Compensation and Inurement.** The media has reported high salaries and generous allowances at some charities and foundations. High

compensation based on the fair value of services an executive performs for the exempt organization is consistent with current law. The key question is whether the compensation is comparable to what similar organizations pay for similar work. The organizations used for comparison may include for-profit as well as nonprofit organizations. The law permits reasonable compensation, even if high. It does not, however, permit excessive compensation.

In March 2007, in a report on executive compensation, we noted that the exempt organizations we examined appeared to generally comply with the law in their compensation practices, but had significant reporting problems. Follow-up work from the project is continuing and includes the redesign of the Form 990, including executive compensation schedules, examinations of loans to executives, and other examination work.

We expect to scrutinize executive compensation in virtually every new exempt organization compliance initiative we conduct. As we continue to gain experience, we will review the use of comparability data to support the compensation amounts and assess the methods used to establish and approve the compensation. We will also be alert to increasing sophistication in the types of compensation exempt organizations use to pay their executives and other key personnel, such as revenue sharing or equity-based arrangements. The new Form 990 we have proposed will strengthen our ability to monitor this area.

**5. Regulation and Reporting of Political Activities.** We also have the responsibility to monitor political activity by exempt organizations. By law, charities cannot intervene in political campaigns, but every election season brings reports of charities supporting or opposing particular candidates. The number of allegations of improper activity, together with increased campaign spending, has raised concerns about whether prohibited funding and activity are growing in 501(c)(3) organizations. To address these issues, the IRS began the Political Activities Compliance Initiative in 2004.

In February 2006, we released a report on our examination of political campaign activity by tax-exempt organizations during the 2004 election campaign. The report concluded that nearly three-quarters of the 82 examinations we completed uncovered some level of prohibited political campaign activity.

We recently released Revenue Ruling 2007-41 which provides guidelines for exempt organizations on the scope of the prohibition of campaign activities by section 501(c)(3) organizations. We also have released a report on our efforts related to the 2006 campaign. In the report we drew comparisons to the 2004 cycle, but for the most part it is too early draw meaningful conclusions about the 2006 campaign.

Political Action Committees (PACs) and other political organizations must file certain reports with us concerning their status, receipts and expenditures,

pursuant to Code section 527(i) and (j). Failure to meet these reporting requirements may result in taxes or penalties. We have begun an initiative to determine whether organizations that claim they are Qualified State or Local Political Organizations, as defined in Code section 527(j), are making this claim properly. Such organizations are exempt from the requirement under Code section 527(j) to report expenditures and contributions.

## **Future Direction of the IRS in Regulating the Charitable Community**

In this part of the testimony, we outline future priorities and our work with respect to each priority: enhancing our compliance impact; enhancing transparency in the operations of charities; and leveraging efforts to improve stewardship of the sector.

### **Continue to Enhance our Compliance Impact**

**Increased efficiency of the determination letter process.** We continue to emphasize and improve our determination letter process. We have revised the application and the manner in which it is processed. As discussed, this has allowed us to reverse a troubling trend in which the time required to process an application had reached unacceptable levels. We will shortly preview an electronic program to assist the taxpayer in filling out the form. The program, the so-called “cyber assistant,” will both educate the applicant and eliminate many errors in the applications. We have also put in place processes by which we can isolate and investigate applications for tax-exempt status in troublesome areas.

**Increased presence in enforcement.** Since 2005 we have continued to shift resources into compliance and enforcement. We have increased examinations by 5.6 percent since 2005, and last year examined over 7,000 returns -- the highest number since 2000. These numbers do not include contacts which, though short of examinations, nonetheless establish direct compliance communication between the IRS and the taxpayer. In 2006, we contacted over 5,200 tax-exempt organizations this way. For example, we sent a nine-page, 81 item questionnaire to a sample of tax-exempt hospitals on the reporting of potential community benefit expenditures and executive compensation.

As discussed above, we have instituted processes that have broadened and strengthened our compliance presence. To cite two examples, we have undertaken studies of non-profit hospitals and the compensation of executives of charities. These studies would not have been possible without the design and staffing of the Exempt Organizations Compliance Unit, one of the new offices within TE/GE. And we continue to focus on key areas, including the above-described executive compensation area, hospitals, non-cash contributions, and political activity.

## **Role of Charities in American Society**

### **In General**

Charities and other tax-exempt entities have always played an important role in the fabric of American life. Tax-exempt organizations meet critical needs in American society. They feed the hungry, shelter the homeless, and care for the elderly. They operate schools, universities, and hospitals. They are our churches. They conduct research that saves lives and provides for a better standard of living. They serve as the backbone of our cultural and artistic life. They preserve our history and our historic buildings; they operate museums, and they engage the desire of Americans to give something back to their communities by offering a vast array of opportunities for volunteer work. In times of crisis, such as the aftermath of September 11 or Hurricane Katrina, the importance of their work is visible for all to see.

Charities and volunteer organizations seem to represent something enduring about Americans. In our history books, we read the story of the creation of such iconic charities as Clara Barton's American Red Cross and Jane Addams' Hull House. Just last year, contributors gave more to charity than ever before. Across the centuries, the charitable impulse has been strong within our country.

The Congress has recognized charities' important role by enacting and preserving section 501 of the Internal Revenue Code, which creates the tax-exemption that charities and other tax-exempt organizations enjoy. The large annual tax-expenditure for tax-exempt organizations represents a strong endorsement by Congress of the work of the charitable community.

### **Demographics of the Tax-Exempt Community**

The tax-exempt sector, which includes more than section 501(c)(3) charities, has been growing rapidly. Since 1997, the number of tax-exempt organizations on the IRS master-file increased by more than 350,000. The total number now approaches 1.6 million, a figure that does not include most churches. These organizations hold assets in excess of \$3 trillion.

Internal Revenue Code section 501(c)(3) describes a subset of the entire tax-exempt sector. Section 501(c)(3) organizations include those organized and operated exclusively for religious, charitable, scientific, educational, and other specified exempt purposes. They are eligible to receive tax-deductible contributions and are subject to certain operating restrictions.

Currently, more than one million tax-exempt organizations are classified as section 501(c)(3) organizations. This includes private charities and private foundations, but not churches, which generally have no filing requirement. Section 501(c)(3) organizations hold assets in excess of \$2.5 trillion (private

pursuant to Code section 527(i) and (j). Failure to meet these reporting requirements may result in taxes or penalties. We have begun an initiative to determine whether organizations that claim they are Qualified State or Local Political Organizations, as defined in Code section 527(j), are making this claim properly. Such organizations are exempt from the requirement under Code section 527(j) to report expenditures and contributions.

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## **Continued Efforts to Enhance Transparency: Getting Better Data and Making it Publicly Available**

Transparency is important in all aspects of tax administration, but it is the linchpin of compliance within the tax-exempt sector. When the structure and operations of charitable organizations are visible to all, the possibility of misuse or abuse of charitable assets is reduced. Equally important, public confidence in the organization and in the charitable sector as a whole is preserved. With that in mind, we have undertaken a number of initiatives that are designed to improve transparency with respect to the activities, fundraising, finances, and governance of charities.

**Redesign of the Form 990.** Transparency begins with adequate reporting. On June 14, 2007, we released for public comment a discussion draft of the new Form 990 and instructions. This redesign is intended to enhance transparency, promote compliance and minimize taxpayer burden. It is the first overhaul of the form since 1979. We are working with our stakeholders throughout the sector to make the redesigned Form 990 the model for transparency. Our goal is to have the new Form 990 ready for use for the 2009 filing season.

**Electronic Filing of Form 990.** One of our key transparency initiatives is to provide charities and others with the ability to file the Forms 990 and 990PF electronically. Electronic filing allows a clear, relatively error-free presentation of the information required on the Form 990. In addition, it allows for all the data to be readily available to the IRS, the states, and the public. We already require electronic filing for large exempt organizations. While this will markedly improve the ability of the IRS, state charity officials, and the public to access Form 990 data in real time, statutory restrictions limit our ability to require e-filing for any organization that files fewer than 250 returns. The Administration's FY 2008 Budget proposal echoes this concern, and includes a legislative proposal that would lower the current 250-return minimum for required electronic filing but maintain the minimum at a high enough level to avoid imposing undue burden on smaller exempt organizations.

**Implementation of the E-Postcard for Small Exempt Organizations.** When charities are not required to file any return, they become difficult for us to monitor, and we are unable to insure that they continue to act in a way consistent with tax-exemption. Congress has recently required small organizations (those with less than \$25,000 in annual gross receipts) to submit a very limited amount of data with the IRS. This will assist the IRS in maintaining contact, educational and otherwise, with these small organizations. Moreover, as we revise the Form 990, we will look at the current filing thresholds for the "e-postcard" and for the Form 990-EZ in an effort to attain the right balance between getting the information we need and not overburdening filers.

## **Working with the Charitable Sector to Improve Governance and Accountability**

Transparency means nothing without ensuring appropriate stewardship of assets held in charitable trust. Thus, governance and accountability are paramount in any meaningful stewardship efforts. The IRS is supporting this work and taking action to ensure that charities are aware of all available tools and practices to succeed in their vital mission.

While we regularly encounter lax governance practices on the part of tax-exempt entities in our examinations, we also see some positive signs that the sector is aware and concerned about such practices. I referred earlier to the impressive efforts of some within the tax-exempt community to establish and gain general acceptance of high standards for governance. We salute this effort. We remain convinced that the presence of an independent, empowered, and engaged board of directors is the key to ensuring that a tax-exempt organization does not misuse or squander the charitable resources in its trust. Such a board helps insure that a tax-exempt organization serves public purposes.

We have also acted to complement the efforts of some in the charitable sector to promote good governance. As we review applications for tax-exempt status, we are encouraging applicants to consider a number of good-governance policies. We are also programming education about good-governance principles into the “cyber-assistant” that we are developing as part of our program to implement an electronic application for tax-exempt status. In addition, the new draft Form 990 includes reporting regarding certain governance practices the charity undertakes. This important work will continue.

### **Conclusion**

While we have found some tax compliance problems in the charitable sector, we remain quite optimistic that through our efforts and the efforts of others, these problems have not reached and will not reach the core of the charitable sector. We remain aware of the need for a balanced program in regulating this sector, a sector that does vital work for our society.

We appreciate the support the Subcommittee has given us in the past, and thank you for your consideration of the FY 2008 IRS Budget. That budget supports our continued emphasis on compliance in the tax-exempt area. It requests a 6.3 percent increase for the IRS as a whole, and a 10.8 percent increase (\$26.4 million) for TE/GE. It will provide a 12.3 percent increase for our examination program and a 12.6 percent increase for our determinations program.

We look forward to continuing our work with all parts of the charitable sector and its progressive leaders. We intend to keep pace with this vibrant sector as it continues to evolve and change. We will work to ensure that the public remains

confident that its contributions of time, effort and money, and the tax subsidies Congress provides to the charitable sector, are used well for the benefit of the public.

Thank you again for the opportunity to be here this morning. I will be happy to answer your questions.

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