Tax Exempt & Government Entities

Advisory Committee on

Tax Exempt and Government Entities (ACT)

2018 Report of Recommendations

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**ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)**

2017-2018 Member Biographies

Susan E. Bernstein, New York, New York

Susan Bernstein is special counsel in the New York office at Schulte Roth & Zabel LLP, where she has been advising employers and plan sponsors on ERISA, employee benefits and executive compensation for 24 years. Bernstein has experience working with all types of employee plans including qualified and nonqualified plans. Bernstein is co-chair of the Employee Benefit and Compensation Committee for the New York State Bar Association and serves on the Executive Compensation and Benefits Committee for the New York City Bar Association. Bernstein has written numerous articles on employee benefit issues in addition to being a frequent speaker on employee benefit topics. Bernstein was named one of Employee Benefit Adviser's Most Influential Women in Benefit Advising. Bernstein holds a J.D. from the Benjamin N. Cardozo School of Law, received her B.A. from the University of Pennsylvania and is a member of the New York Bar.

Judith Boyette, San Francisco, California

Judith Boyette is a partner in Hanson Bridgett LLP, a San Francisco law firm, and is the senior partner in the firm's Employee Benefits Group. Prior to joining her law firm, Boyette spent more than 10 years at the University of California as the Associate Vice President of Human Resources and Employee Benefits. Boyette's clients include single employer and multi-employer plans, 403(b) plans, church plans and governmental plans. Boyette received a J.D. from the Hastings College of the Law and is a member of the California Bar.

Natasha Cavanaugh, Seattle, Washington

Natasha Cavanaugh is a tax attorney for the Bill & Melinda Gates Foundation. Prior to joining the Gates Foundation, Cavanaugh served as lead tax attorney at a major public research university where she managed complex tax matters, including the university's medical resident FICA tax refund claim. When in private practice, Cavanaugh

represented educational organizations, museums, private foundations and other tax-exempt organizations. Cavanaugh has a J.D., University of Virginia, M.A., Sociology and a B.A., Economics, Stanford University.

David Danenfelzer, Austin, Texas
David Danenfelzer is a community development professional committed to advancing the fields of nonprofit management, community planning and public finance. His current employer, Texas State Affordable Housing Corporation, is a statewide nonprofit housing finance corporation. Danenfelzer has helped Texas State Affordable to increase investment in affordable housing, redesigned its multifamily bond finance programs and created the first statewide affordable housing land bank. Danenfelzer is an alumnus of the University of Wisconsin at Madison and received his MSCRP at the University of Texas at Austin.

Michael Engle, Kansas City, Missouri
Michael Engle has extensive experience working with tax-exempt organizations and governmental entities on various tax issues including employment tax. He has direct experience working with nonprofit hospitals and colleges and universities. He has written a number of technical articles and has been a presenter for conferences and webinars. He is a CPA and actively involved with the AICPA. He serves on the BKD, LLP nonprofit committee and is the leader of their health care committee. He is involved with the AICPA and Missouri Society of CPAs.

Marcelino Gomez, Phoenix, Arizona
Marcelino Gomez previously served as the Assistant Attorney General (Tax and Finance) at the Navajo Nation Department of Justice for 26 years and as an Assistant General Counsel at the Salt River Pima-Maricopa Indian Community. Gomez represented the tribal governments on matters related to federal and state taxes including the risk management, employee benefit and retirement programs. Gomez is now in private practice in Phoenix, Arizona. Gomez received a B.B.A. in Accounting from New Mexico State University and a J.D. from the University of Texas School of

Law. Gomez is a member of the State Bars of Arizona, New Mexico and Texas, the Navajo Nation Bar Association and the ABA Tax Section.

William Johnson, Dallas, Texas

William Johnson is the Managing Director for First Southwest Asset Management. Johnson is responsible for managing, mentoring and strategic planning for 18 rebate professionals who serve clients nationwide. His client relationship responsibilities include rebate liability planning and implementation of tax law changes for tax-exempt obligation issuers. Johnson is responsible for developing and implementing post issuance rebate compliance policies and procedures for arbitrage clients including not for profit, state and local government, and private activity issuers. Johnson earned his B.B.A. degree in Accounting from Southern Methodist University and an M.S. degree in Taxation from Texas Tech University. Johnson is a member of the AICPA, Texas Society of CPAs and is a licensed CPA in Texas. Johnson is also registered with FINRA as a General Securities Representative, Series 7; General Securities Principal, Series 24; Municipal Advisor Representative, Series 50 and a Uniform Securities Agent, Series 63.

Andrew Lipkin, New York, New York

Andrew Lipkin is an attorney and now Senior Tax Counsel for New York City, and has management responsibility for other attorneys. He provides counsel to his employer, and is familiar with issue affecting federal, state and local governments.

Cindy M. Lott, New York, New York

Cindy Lott serves as Academic Program Director for Nonprofit Management Programs at Columbia University's School of Professional Studies. Prior to her current position, Lott served as Executive Director and Senior Counsel to the National State Attorneys General Program at Columbia Law School, and within that program was the developer and lead counsel to the Charities Regulation and Oversight Project from 2006 to 2015. Currently, Lott is also a Senior Fellow at the Center on Nonprofits and Philanthropy at the Urban Institute, working in conjunction with the Institute's Tax Policy and Charities project. Lott develops and moderates a series of national convenings on state and

federal regulation of the charitable sector and is engaged in research regarding regulatory capacity and enforcement at the state level. Lott is a graduate of the Yale Law School and clerked for the United States Court of Appeals, First Circuit. Lott is admitted to practice in the District of Columbia, Indiana and Massachusetts.

Jean Swift, Mashantucket, Connecticut

Jean Swift is the Treasurer of the Mashantucket Pequot Tribal Council where she has served since October 2013. She chairs the Tribe's Finance and Economic Development Committees, and serves as Vice Chair for the Tribe's Endowment Trust Board of Directors. Jean is a CPA in the State of Connecticut, and a board member for the Connecticut Community Credit Union, serving as its Supervisory Committee Chairperson. She also serves on the board for the Eastern Connecticut Chamber of Commerce, and is serving a three-year term on the Advisory Council for the IRS TE/GE, representing Indian Tribal Governments. Swift has a B.S. in Business Administration from the University of Connecticut and an M.B.A. from the Keller Graduate School of Management at DeVry University.

GENERAL REPORT
OF THE ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES (ACT)

This General Report is presented in connection with the 17th annual public meeting of the Internal Revenue Service (IRS) Advisory Committee on Tax Exempt and Government Entities (ACT).

The ACT was established in 2001 with the purpose of fostering public discussion of issues relevant to five Tax Exempt and Government Entities (TE/GE) functions. The Charter for the ACT provides that the ACT members will present in an organized and constructive fashion the interested public's observations about current or proposed TE/GE programs and procedures and will suggest improvements. As described in its Charter, the ACT's purpose is to provide an organized public forum for discussion between IRS officials and representatives of the five areas within the jurisdiction of the TE/GE Division: Employee Plans (EP), Exempt Organizations (EO), Federal, State and Local Governments (FSLG), Indian Tribal Governments (ITG) and Tax Exempt Bonds (TEB). This year, of the ten members of the ACT, two represent EP, three represent EO, one represents FSLG, two represent ITG and two represent TEB. These five groups were designed to ensure that substantive areas that may easily be otherwise overlooked received an opportunity to communicate to the IRS about trends, concerns and opportunities. Historically, the ACT has interacted with IRS leadership to address issues affecting TE/GE constituents, which represents more than three million customers and entities and approximately $245 billion in federal tax expenditures. Although not subject to income taxes, the TE/GE entities must comply with specialized and highly complex provisions of tax law. It is also important to note the extremely diverse customer base served, including small local community organizations and municipalities to major universities, huge pension funds, state governments, Indian tribal governments and complex tax-exempt bond issuers.

For 17 years, the ACT's members have had the opportunity to report to the IRS and the public on specific aspects of the TE/GE interactions with its stakeholders providing an

important link to the stakeholder public. TE/GE uses the ACT and its functional area subgroups for ongoing consultation in the hope of improving the administration of the tax law and the relationship of the IRS to its constituencies. This year the ACT presents the following five reports to the Commissioner, TE/GE Division:

- **Employee Plans**: Recommendations Regarding Re-Opening the Determination Letter Program
- **Employee Plans**: Recommendations Regarding Missing Participants
- **Exempt Organizations**: Recommendations Regarding Incentivizing E-Filing for Form 990
- **Indian Tribal Governments**: Recommendations Regarding IRS Sharing of Taxpayer Information with Tribal Government Tax Programs
- **Tax Exempt Bonds**: Recommendations to Encourage Self-Compliance by Issuers of Tax-Advantaged Obligations

The ACT appreciated the cooperation of the IRS and access to its personnel and resources to ensure that the ACT can present meaningful insight and recommendations to the IRS. The ACT worked with numerous constituent groups -- their collaborative efforts made our recommendations possible. The ACT hopes these recommendations will prove helpful to TE/GE personnel and the communities with which they interact.

Acknowledgements and Recognition

As each year passes, we have a number of ACT members who completed their terms:

- Susan Bernstein, Schulte Roth & Zabel LLP (EP)
- Judith Boyette, Hanson Bridgett LLP (EP)
- Natasha Cavanaugh, Bill & Melinda Gates Foundation (EO)
- Cindy Lott, Columbia University School of Professional Studies (EO)
- Marcelino Gomez, Private Practice (ITG)
- David Danzenfelzer, Texas State Affordable Housing Association (EO)
- William Johnson, First Southwest (TEB)

Each member has made significant contributions to the ACT. I would like to thank each of these members for their support, unique insights, wisdom, service and friendship. It has been a pleasure and a privilege to get to know and work with all the departing members.

The ACT wishes to acknowledge and express our ongoing gratitude for the IRS's willingness to look to the ACT for its insights. We would like to thank IRS leadership for their ongoing support of our activities over the past year. The ACT specifically thanks Commissioner John Koskinen and Acting Commissioner David Kautter for their leadership, Commissioner Sunita Lough and Acting Commissioner David Horton for their input and interest, all the TE/GE Division directors, and all the TE/GE staff for the support and assistance you've provided to the ACT throughout the year. The members of the ACT recognize that the IRS continues to dedicate significant resources to the ACT, even in light of very significant constraints on its operations. However, the insights provided by the ACT reports would not be possible without the IRS's greatest strength – its dedicated employees – and their willingness to work in a collaborative and open manner with the ACT. Special thanks to Mark O'Donnell, the Designated Federal Officer to the ACT and TE/GE's Communications & Liaison Director and his team, Melaney Partner and Nicole Swire for handling the logistics for our meetings, conference calls and technology needs for surveys and other information-gathering activities. Special thanks, as well, to all those who participated in the surveys, focus groups and other information gathering critical to the analysis and recommendations made in the various subcommittee reports.

Lastly, in that this report also concludes my term on the ACT, I include a few personal notes of appreciation. For me, serving on the ACT for the past three years has been a rewarding personal and professional experience, and being chair this year has been exceptionally interesting as I have been able to participate in dramatic changes being made within TE/GE and to the ACT. I enjoyed working with and learning from all the TE/GE leadership and the other ACT members with whom I have served. I would particularly like to take this opportunity to thank Vice Chair Natasha Cavanaugh for all her wisdom and efforts.

On behalf of the ACT, we hope that our input has been helpful to the IRS and to the constituent groups that we serve. We further hope that the ACT continues to have an important role in the future in fostering public discussion of issues relevant to five TE/GE functions and improving the administration of the tax law and the relationship of the IRS to its constituencies.

Susan E. Bernstein
Chair, June 2017 to 2018

ADVISORY COMMITTEE ON

TAX EXEMPT AND GOVERNMENT ENTITIES

(ACT)

Employee Plans Subgroup

Recommendations Regarding Re-Opening the Determination Letter Program

Judith Boyette, Project Leader
Susan E. Bernstein
Andrew G. Lipkin

June 7, 2018

RECOMMENDATIONS REGARDING RE-OPENING THE DETERMINATION LETTER PROGRAM

I. EXECUTIVE SUMMARY

The 2015-2016 report by the Employee Plans Subgroup (EP Subgroup) of the ACT examined the major restructuring of the Internal Revenue Service determination letter program for qualified plans (the Determination Letter Program) and the resulting impact on the various constituents of the employee plans community (EP Community). As a follow-up to that report, this EP Subgroup has chosen to further analyze and make recommendations regarding the circumstances under which it may be appropriate for the IRS Office of Employee Plans (EP) (the part of the Tax Exempt and Government Entities Division (TE/GE) of the IRS responsible for qualified pension plans) to re-open the Determination Letter Program under certain defined circumstances. In undertaking this analysis, the EP Subgroup is acutely aware of the constraints that have been placed on EP due to budgetary shortfalls and personnel reductions. The EP Community greatly appreciates the willingness of EP to consider opening the Determination Letter Program for individually designed retirement plans that have made amendments since the issuance of their last favorable determination letter. The willingness of the IRS and the Department of Treasury to consider a potential expansion of the Determination Letter Program for a limited time period was publicly acknowledged in Notice 2018-24.[1] Notice 2018-24 requests comments by June 4, 2018, as to the specific types of plans and the circumstances (other than initial qualification and plan termination) for which the IRS might consider accepting determination letter applications during the 2019 calendar year. The EP Subgroup hopes that this report, along with other public comments, will be useful in the IRS review process.

II. BACKGROUND

On July 21, 2015, the IRS announced[2] that the staggered five-year remedial amendment cycle system (the Cycle System)[3] for determination letters would end on

[1] Notice 2018-24, IRB 2018-17, 507.
[2] Announcement 2015-19, IRB 2015-32, 157.
[3] The Cycle System was created under Revenue Procedure 2005-66 (2005-2 C.B. 509, August 26, 2005).

January 31, 2017, at the conclusion of the Cycle A submission period. After that date, sponsors of individually designed plans are able to submit requests for determination letters only upon initial qualification or termination of a plan, except for limited to-be-specified-later exceptions.

Section 401(b) of the Internal Revenue Code (IRC)[4] provides for a remedial amendment period during which a plan may be retroactively amended to comply with the IRC qualification requirements. The IRS used its discretion to establish five-year remedial amendment periods under the Cycle System based on the assigned cycle for the plan sponsor.[5] Submissions in the Cycle System had to demonstrate that interim amendments for items on the Cumulative List of Changes in Plan Qualification Requirements (Cumulative List) issued for that plan's cycle had been timely adopted. In general, plan sponsors of individually designed plans that wanted to preserve reliance on a plan's favorable determination letter had to apply for a new determination letter for each remedial amendment cycle during the last 12 months of their plan's remedial amendment cycle (in other words, between February 1 and January 31 of the last year of the cycle). In this way, the Cycle System had allowed plan sponsors or plan administrators to file for a determination letter every five years to cover plan amendments made since the issuance of the prior determination letter (both discretionary and Cumulative List amendments). Plan sponsors were assigned to a Cycle, lettered sequentially as Cycles "A" through "E," based on the last digit of the plan sponsor's federal employer identification number (EIN), with special submission cycles for governmental, multiple employer and multiemployer plans.

A favorable IRS determination letter verifies that the sponsor has timely amended its plan document to incorporate all required law and regulatory changes since the issuance of the immediately preceding determination letter and that all the discretionary amendments made to the plan were timely and met substantive requirements. The

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[4] All section references are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder, unless otherwise specified.
[5] See Treas. Reg. Section 1.401(b)-1(f); Rev. Proc. 2007-44, 2007-28 IRB 54.

determination letter only addresses the plan document requirements of the IRC. It does not address operation of the plan. Nevertheless, because of the protection it offers from disqualification on the account of document failures, its availability had been viewed as integral to a plan sponsor's decision to offer and maintain a plan.[6]

After the IRS ended the Cycle System, the IRS issued guidance to clarify that expiration dates included in determination letters issued prior to January 4, 2016, will no longer be operative, and that determination letters issued after January 4, 2016, will no longer include expiration dates.[7] However, IRS guidance continues to indicate that a determination letter "may not be relied upon after a change in material fact or the effective date of a change in law [except as specifically provided in Revenue Procedure 2018-4]."[8] Without further guidance from the IRS on what might constitute a "change in material fact," plan sponsors are concerned that making any change could jeopardize the audit protection afforded by having a current favorable determination letter.

While the IRS stated in Announcement 2015-19 that it was contemplating allowing individually designed plans to apply for determination letters in certain limited situations, the IRS has not yet specified the parameters for any such limited submissions. In Notice 2018-24, the IRS now has requested comments regarding the types of plans and circumstances under which such a limited re-opening might occur during the 2019 calendar year. This report provides recommendations regarding parameters that could be established to allow for implementation by the IRS of a limited re-opening for determination letter applications for individually designed plans not just for calendar year 2019, but also more broadly and systematically.

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[6] If a plan is tax-qualified, employer contributions and earnings on contributions are not included in the employee's taxable income until such amounts are distributed (even though the arrangement is funded and even if benefits are vested). Additionally, if tax-qualified, many plan distributions can be rolled over to another type of retirement plan or IRA for further deferral of income inclusion. In the case of a taxable employer, the employer is entitled to a current deduction (within certain limits) for contributions even though the contributions are not currently included in employees' income. The contributions and earnings are held in a tax-exempt trust, which enables the plan's assets to grow on a tax-free basis until distribution. Loss of tax-qualified status thus involves significant tax risk for all parties.
[7] Rev. Proc. 2018-4, 2018-1 IRB 146, Section 23.02(2).
[8] Rev. Proc. 2018-4, 2018-1 CB 121, Section 23.02(1).

The EP Subgroup took multiple steps to determine the views of the EP Community and to develop its recommendations regarding the limited re-opening of the Determination Letter Program. The steps included a review of the Comment Letters received by the IRS regarding the ending of the Cycle System focusing on comments pertaining to the limited re-opening issue. The EP Subgroup also held discussions with a number of professional groups and associations within the EP Community. Finally, the EP Subgroup solicited background information from EP personnel. Robert S. Choi, Director of EP during the period of the development of this report, generously made himself and his staff available so that the EP Subgroup could obtain important background information used in shaping the EP Subgroup's recommendations. EP also provided the EP Subgroup with pertinent statistical data, which provided valuable insight into the nature and volume of determination letter application filings, the various types of plans submitting applications, the status of IRS case processing under the last cycle and other related information.

The feedback received by the EP Subgroup from the EP Community was uniformly positive when learning that EP is considering re-opening the Determination Letter Program for certain situations and that the IRS is receptive to receiving input on possible approaches.

III. RECOMMENDATIONS

The EP Subgroup continues to believe that an opportunity to receive an updated IRS determination letter serves as an important adjunct to the IRS audit program, and would play a major role in encouraging plan sponsors and plan administrators to regularly review not only their plan documents, but also plan operations, in preparation for periodic IRS filings. These recommendations are offered in the spirit of encouraging the IRS to consider providing this service on a limited basis.

1. Confirm through easily accessible information sources, such as the IRS website and IRS presentations to EP Community associations, that the plan sponsor or plan administrator may continue to rely on a favorable determination letter issued under the Cycle System with respect to all plan language other than amended

language, provided that there has been no change in the law that would affect the portion of the plan that has not been amended.

2. Institute a new procedure to allow for a limited scope determination letter under which a plan sponsor or plan administrator could ask the IRS to review specified changes since the issuance of a prior favorable determination letter. Under this limited scope review process, the plan sponsor or plan administrator would identify specific language that had been adopted since the last determination letter, in a format similar to the manner used with Form 5307, Application for Determination for Adopters of Modified Volume Submitter Plans. This would result in a "limited scope" determination letter that would cover only the specified changes that are submitted for review. The prior favorable determination letter for the plan would continue in effect for any provisions not changed since the prior favorable determination letter. This limited scope review could be limited to discretionary amendments, or could also be limited to amendments addressing items listed in the annual Required Amendments List.

   The EP Subgroup recognizes that prior to the introduction of the Cycle System the IRS had a limited review program using Form 6406, Short Form Application for Determination for Minor Amendment of Employee Benefit Plan. In our discussions with EP staff, representatives indicated that there were problems with this process because amendments that were presented as "minor" could involve more substantial changes when viewed from the standpoint of the entire plan document. Some IRS agents found that they had to review the entire plan document to determine if the "minor" amendments had an effect on other plan terms. While the EP Subgroup appreciates that there were challenges with the prior limited review program and a new limited scope review program may raise some of the same challenges, the EP Subgroup believes that there should be a way to add appropriate caveats to a new "limited scope" determination letter that would place the burden on the requestor to identify any such effects or the requestor could not rely on the limited scope letter.

3. Allow submission of determination letter applications for plan amendments required by major business transactions, such as plan sponsor mergers and acquisitions, divestitures, joint ventures and bankruptcy proceedings, as well as for plan mergers and spin-offs. Without access to the determination letter process, the parties to these types of transactions likely may require plan termination as a condition of closing the transaction in order to limit potential liability for a plan that has an outdated determination letter. While it has been the case that plan terminations have been required as part of the closing requirements for transactions prior to the elimination of the periodic determination letter program, the EP Subgroup is concerned that plan terminations will become even more common without the ability to obtain current letters for ongoing plans. More frequent plan terminations would not be in the best interests of plan participants. Because these transactions are often time sensitive, it is recommended that an expedited review process be made available in these cases.

4. Allow submission of determination letter applications for plan amendments adopted to comply with requirements published annually by the Treasury and IRS as a Required Amendments List for individually designed plans that generally applies to changes in qualification requirements that become effective on or after January 1, 2016.[9] To facilitate the best use of the IRS reviewers' time, require that the plan sponsor or plan administrator include with the determination letter application a “redlined” version of the last plan document that was the subject of a favorable determination letter, marked to show the subsequent changes responding to the Required Amendments Lists. More generally, the EP Subgroup recommends that the IRS require that the plan sponsor or plan

[9] The annually issued Required Amendments List establishes the date that the remedial amendment period expires for changes in qualification requirements contained on that list. The IRS has indicated that IRS review of determination letter requests for individually designed plans will be based on the applicable Required Amendments Lists and take into account Cumulative Lists issued prior to 2016 under the Cycle System. (Rev. Proc. 2016-37, 2016-29 IRB 136, Sections 9 and 12.)

administrator include with any determination letter application a "redlined" version of the last plan document that was the subject of a favorable determination letter, marked to show any subsequent changes.[10] This should support a more efficient IRS review process.

5. Issue guidance that makes clear that if the only change in plan provisions is the name of the plan sponsor and/or the plan name (for example, in the case of an assumption of an ongoing plan by a buyer or in the case of a spin-off of a "cloned" plan as part of a divestiture transaction), then the prior favorable determination letter can be relied upon by the "new" plan sponsor.[11] Since it is necessary under industry practice in certain situations for the plan to provide a copy of its most recent favorable determination letter (such as for investment vehicles, use in establishing tax-exempt status for foreign tax authorities and so on), the IRS should implement a simple administrative process where a new determination letter with the new name of the plan sponsor and/or the new plan name (bearing the date of the original letter) can be issued in these situations.

6. Allow submission of determination letter applications in the event of a major change in the tax law applicable to tax-qualified plans and provide model language for amendments to facilitate the review process in these cases.

7. Allow submission of determination letter applications for any plan that has had significant changes, including a major design change (such as a change to a hybrid plan) or a novel qualification issue, that the plan sponsor or plan

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[10] This would be similar to the process used with Form 4461, Application for Approval of Master or Prototype or Volume Submitter Defined Contribution Plan, and Form 4461-A, Application for Approval of Master or Prototype or Volume Submitter Defined Benefit Plan, under which the requestor must provide a description of each place where the plan for which the application is being submitted is not identical word-for-word to the language of the lead plan (including an explanation of the purpose and effect of each difference), and a certification, made under penalty of perjury by the plan drafter, that the information describing where the plan language is not identical word-for-word is true and complete.

[11] The administrative action requested in this recommendation would seem to parallel the action taken in recently issued Revenue Procedure 2018-15 (2018-9 IRB 379). Rev. Proc. 2018-15 provides that a domestic organization exempt from taxation under IRC Section 501(c) is not required to file a new application for exemption under certain corporate restructuring situations where the surviving entity continues to carry out the same purposes as the organization had been before the restructuring.

administrator believes may represent a “material change” such that reliance on the most recent favorable determination letter is not appropriate. Allow governmental plans access under this exception to the extent there are significant changes in state law significantly affecting the terms of a plan.

8. To encourage conversion of individually designed plans to pre-approved plan documents when feasible, expand IRS instructions for the pre-approved 401(a) plan and 403(b) plan programs by providing further guidance on the type of changes that would be considered "minor modifications."[12] The EP Subgroup also urges the IRS to consider further changes to make the pre-approved plan programs available as broadly as possible to the EP Community. In reviewing EP Community comments, the EP Subgroup found many of the changes suggested by the American Retirement Association in its comment letter to EP dated February 23, 2016[13] offer practical ways to enhance the usefulness of the program. For example, adding IRC Section 457(b) plans to the existing pre-approved plan program would be very beneficial to the EP Community.

9. In addition, since more plan sponsors are now contemplating conversion to a pre-approved plan option, the IRS should consider extending adoption deadlines under the pre-approved plan program. Under current IRS rules, all pre-approved plan document providers must completely update their pre-approved plan documents and request new opinion/advisory letters from the IRS every six years.[14] Generally, plan sponsors operating under the pre-approved plan document must then adopt a new updated pre-approved plan within two years after the IRS issues its opinion/advisory letter for the pre-approved plan. If that process occurs, the plan sponsor may rely on the advisory/opinion letter issued

[12] The latest procedures for obtaining IRS approval of pre-approved 401(a) plan documents are provided under Revenue Procedure 2015-36 (2015-27 IRB 20) and procedures for obtaining approval of 403(b) plan documents are provided under Rev. Proc. 2013-22 (2013-18 IRB 985, as modified by Rev. Proc. 2014-28 (2014-6 IRB 944), Rev. Proc. 2015-22 (2015-11 IRB 754), and Rev. Proc. 2017-18 (2017-5 IRB 743).).
[13] http://www.asppa-net.org/Portals/2/PDFs/GAC/Comment%20Letter/Enhancements_Pre-Approved_Plan_Programs_Comment_Letter2-23-16.pdf.
[14] See Revenue Procedure 2015-36, 2015-27 IRB 20; Rev. Proc. 2013-22, 2013-18 IRB 985.

to the plan document provider.[15] Similarly, if a plan sponsor wishes either to convert from an individually designed plan document to a pre-approved plan document, or to adopt a pre-approved plan of a different document provider, those actions must be taken during an IRS-specified time period, generally two years following the approval of the new plan document. EP Community feedback indicates that these two-year periods need to be extended or eliminated because plan sponsors struggle to comply with the relatively short adoption period currently authorized.

10. Allow submission of determination letter applications upon the expiration of a stated period of time since the last favorable determination letter (for example, 10 or 15 years). There is a concern that the industry may require a more recent letter to establish tax-qualified status because a prior letter, although not technically expired, will be considered too stale to be relied upon (such as for investment vehicles, use in establishing tax-exempt status for foreign tax authorities and so on). An alternative would be to allow submissions upon the earlier of a stated period of time (for example, 10 years) or the adoption of 10 or more amendments to the plan. The EP Community indicated that any reasonable limitations on how many times a plan sponsor could utilize this process, such as no more than once in every five years, would be acceptable.

11. Allow access to determination letters for certain plans that cannot currently fall within the pre-approved program limitations, such as multiemployer plans, governmental plans with statutory structures, hybrid plans and complicated employee stock ownership plans.

12. If IRS workload management is a concern, the EP Community is receptive to rules that stagger the deadline to submit determination letter applications that are not based on a transaction date (for example, last determination letter date more

[15] See Revenue Procedure 2016-37, 2016-29 IRB 136.

than 10 or 15 years ago). There are a number of methods that could be used to stagger the application deadlines more evenly throughout the IRS fiscal year. For example, this could involve imposing deadlines based on the type of plan (in other words, January 1, 2019 - June 30, 2019 filing period for defined benefit plans with material changes; July 1, 2019 - December 31, 2019 filing period for defined contribution plans with material changes; January 1, 2020 - June 30, 2020 filing period for multiemployer defined benefit plans with material changes; July 1, 2020 - December 31, 2020 filing period for multiemployer defined benefit plans with material changes; January 1, 2021 - June 30, 2021 filing period for governmental defined benefit plans with material changes; July 1, 2021 - December 31, 2021 filing period for governmental defined contribution plans with material changes). Alternatively, this could involve six-month staggered filing periods for submissions by plan sponsor EIN, or any other similar methods that could be used to produce six-month staggered filing periods. The comments received by the EP Subgroup indicate that the EP Community would be willing to use any type of staggered filing program that might assist the IRS in its workload management, so long as access to the determination letter process was provided in some manner.

ADVISORY COMMITTEE ON

TAX EXEMPT AND GOVERNMENT ENTITIES

(ACT)

Employee Plans Subgroup

Recommendations Regarding Missing Participants

Susan E. Bernstein, Project Leader

Judith W. Boyette

Andrew G. Lipkin

June 7, 2018

RECOMMENDATIONS REGARDING MISSING PARTICIPANTS

I. EXECUTIVE SUMMARY

The Employee Plans Subgroup (EP Subgroup) of the Advisory Committee on Tax Exempt and Government Entities (ACT) examined compliance concerns for tax-qualified retirement plans with respect to participants and beneficiaries who cannot be found or are not responsive (Missing Participants). The challenges affect plans of all sizes. Plan sponsors may lose touch with participants over time for several reasons. Participants may have moved without providing forwarding information or, in many cases, the plan sponsor may have had bad data from the outset. Sometimes participants provide the plan sponsor with erroneous information or data such as dates of birth, Social Security numbers or ZIP Codes. Further, participants and beneficiaries can lose track of plans in which they previously participated as they transition between jobs in their working career, a common occurrence due to the nature of today's mobile workforce. This is further complicated as companies go out of business, declare bankruptcy, are acquired, spin-off or merge with other companies. As plans are terminated or merged as a part of corporate restructuring, it is difficult for plan sponsors and participants to keep track of one another.[16]

Missing Participants present significant challenges for plan sponsors seeking to maintain compliance with applicable law and governing plan documents. The Internal Revenue Code (IRC)[17] mandates when a plan must begin making distributions. It is unclear how plan sponsors can satisfy this requirement for benefits payable to Missing Participants. Issues related to the payment of required minimum distributions (RMDs) has become a focus of recent U.S. Department of Labor (DOL) examinations and the DOL has issued findings in recent investigations which conflict with IRS guidance. The EP Subgroup recommends the IRS issue further guidance to help plan sponsors navigate these challenges and maintain compliance with applicable law.

[16] https://www.gao.gov/assets/670/667151.pdf at 26.
[17] All section references are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder, unless otherwise specified.

II. BACKGROUND

Scope of the Missing Participant Problem

Sponsors of qualified plans are concerned about how to comply with IRS requirements involving payments to Missing Participants. Plan sponsors often first discover that participants are missing when participant statements, summary annual reports or other communications are returned to the plan sponsor as undeliverable with no forwarding address provided. Plan sponsors generally seek to inform participants that they have a duty to keep their contact information up-to-date, yet problems abound.[18] Plan sponsors have no automatic method to keep information updated if former employees fail to inform their employer of changes in name and/or address.[19] Participants are classified on Form 5500 (Annual Return/Report of Employee Benefit Plan) as (a) active, retired or separated receiving benefits; (b) retired or separated entitled to future benefits, or (c) deceased with beneficiaries receiving or entitled to benefits.[20] The DOL estimates that during 2014 alone, there were more than 42 million inactive participants in qualified plans and some portion of those are missing.[21] According to a U.S. Government and Accountability Office (GAO) report called "Greater Protections needed for Forced Transfers and Inactive Accounts" issued in November 2014, which analyzed protections needed for inactive plan accounts, the scope of the problem is substantial. The GAO reported that millions of employees change jobs each year. Low-wage workers and young workers are particularly likely to become Missing Participants because they change jobs more often.[22] The median tenure for workers age 20 to 24 is just 1.3 years.[23] The scope of the problem is concerning. Although the total dollars attributable to Missing Participants has not been determined, the larger population of separated

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[18] Susan Bernstein, Esq., *IRS Provides Some Relief On Missing Participant Compliance Concern*, Tax Management Compensation Planning Journal, Vol. 46, No. 1, p. 10, 01/05/2018.
[19] https://www.gao.gov/assets/670/667151.pdf%20.at 25.
[20] https://www.dol.gov/sites/default/files/ebsa/employers-and-advisers/plan-administration-and-compliance/reporting-and-filing/form-5500/2016-instructions.pdf at 17.
[21] https://www.dol.gov/sites/default/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf.
[22] https://www.gao.gov/assets/670/667151.pdf at 21.
[23] Data from the U.S. Bureau of Labor Statistics for both men and women in January 2012. http://data.bls.gov/cgi-bin/print.pl/news.release/tenure.t01.htm.

employees has left 16 million accounts unclaimed that exceeded $8.5 billion between 2004 and 2013.[24] Not all these separated employees are Missing Participants and not all the unclaimed accounts are treated by plans as forfeitures. It is estimated that the majority of Missing Participant accounts are valued individually at less than $3,000.[25] The GAO acknowledges that when participants terminate, the "onus is on them to update former employers with address and name changes, and to respond to their former plan sponsor's communications."[26] This is a critical point – plan sponsors have to do their part to search for Missing Participants, but when reviewing plan sponsors for compliance, regulators should keep in mind that participants have obligations to do their part as well.

Sponsors of qualified plans must navigate all the IRS tax-qualified plan distribution requirements to maintain the tax-qualified status of their plans.[27] For example, IRC Sections 411(a)(11) and 401(a)(31) provide that a plan can be designed to force a distribution of a participant's benefit upon his or her termination from employment before normal retirement age, regardless of the participant's age or service, if the vested benefit does not exceed $5,000 (or, in some cases, $1,000), referred to as mandatory small sum cash-outs. Qualified plans are required to commence payment under IRC Section 401(a)(14) no later than 60 days after the latest of:

1. the earlier of attainment by the participant of age 65 and normal retirement age defined by the plan,
2. the tenth anniversary of the date on which the participant commenced participation in the plan,
3. termination of the participant's service with the employer, or
4. the date specified in a written election made pursuant to Treas. Reg. 1.401(a)(14)(b).[28]

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[24] https://www.gao.gov/assets/670/667151.pdf citing SSA analysis of Form 8955-SSA data.
[25] http://www.eric.org/uploads/doc/retirement/PBGC_MissingParticipantsRFI_CmtLtr_082013.pdf
[26] https://www.gao.gov/assets/670/667151.pdf at 26.
[27] Bernstein at 1.
[28] IRC Section 401(a)(14); 26 C.F.R. 1.401(a)-(14).

Furthermore, IRC Section 401(a)(9) requires that qualified plans commence distribution of RMDs to employees not later than the required beginning date, which is generally defined as April 1 of the calendar year following the later of the calendar year in which the participant attains age 70½ or the calendar year in which the employee retires from employment.[29]

It can be difficult to find financial institutions willing to open rollover accounts for the mandatory small sum cash-outs. Further, many Missing Participants have benefits that are in excess of $5,000 and therefore are ineligible to be automatically rolled over to an IRA without their consent. Plan sponsors commonly use the forfeiture and reinstatement procedure pursuant to Treas. Reg. Section 1.411(a)-4(b)(6), which provides a mechanism to forfeit benefits of Missing Participants as long as reinstatement is done if the Missing Participant subsequently makes a claim.[30] The DOL appeared to agree when it stated that the authority to interpret the meaning of "forfeited benefit" as used in Treas. Reg. Section 1.411(a)-4(b)(6) resides with IRS/Treasury.[31] The Pension Benefit Guaranty Corporation (PBGC) confirmed the forfeiture and reinstatement procedure when it acknowledged that a forfeited benefit should be "disregarded for purposes of determining the plan's current liability" and for the variable-rate premium.[32] Nevertheless, the DOL has subsequently raised informal concerns that the forfeiture and reinstatement procedure can result in a prohibited transaction triggering a 15 percent excise tax under IRC Section 4975. Given the foregoing, plan sponsors need consistent inter-agency guidance on the use of the forfeiture and reinstatement provision; it is unworkable for plan sponsors if the IRS authorizes a method and the DOL treats such method as a prohibited transaction.

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[29] IRC Section 401(a)(9); 26 C.F.R. 1.401(a)(9)-2.
[30] Bernstein at 4.
[31] Questions and Proposed Answers for the Department of Labor Staff for the 2006 Joint Committee of Employee Benefits Technical Session (May 3, 2006). (https://www.americanbar.org/content/dam/aba/migrated/2011_build/employee_benefits/2006_qa_dol.authcheckdam.pdf).
[32] PBGC Blue Book 2004, Q&A-2.

What happens when a plan sponsor cannot timely comply with one or more of the applicable IRS distribution requirements because the payees are Missing Participants despite best efforts to locate them? The consequences of noncompliance can be extreme. If a plan fails to comply with applicable qualification requirements such as a mandatory distribution, the plan risks the loss of its tax-qualified status.[33]

Furthermore, we understand from conversations with EP Staff that EP examiners get stuck on some of these very same issues, which causes delays in closing examinations. EP Staff indicate that they also would welcome further guidance and/or field directives.

The Missing Participant problem recently reached the attention of Congress with the introduction of bipartisan legislation. On February 28, 2018, Republican Senator Steve Daines of Montana and Democratic Senator Elizabeth Warren of Massachusetts introduced bipartisan legislation, the Retirement Savings Lost and Found Act of 2018, to help address the Missing Participant problem.[34] If enacted, the bill would direct the Commissioner of Social Security and the Secretary of the Treasury to jointly establish an online mechanism to help locate and track Missing Participants. The legislation would create the Office of Retirement Savings Lost and Found, which would act as a clearinghouse for retirement plan information and require employers to provide data to a national searchable database. It would also require plan sponsors to send lost, uncashed checks of less than $1,000 for nonresponsive participants who are not necessarily missing to Treasury so that participants can locate the money and save for retirement. The legislation has the support of AARP and the ERISA Industry Committee (ERIC).[35]

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[33] Bernstein at 2.
[34] "S. 2474-115th Congress: Retirement Savings Lost and Found Act of 2018." www.GovTrack.us/congress/bills/115/s2474.
[35] https://www.warren.senate.gov/imo/media/doc/Retirement%20Savings%20Lost%20and%20Found%20Act%20of%202018%20(fact%20sheet)1.pdf.

DOL Guidance on Missing Participants

The DOL issued guidance to sponsors of terminated qualified plans on what it considers to be reasonable steps to search for Missing Participants in the context of terminated plans. According to DOL Field Assistance Bulletins (FAB) 2004-02 and 2014-01, a plan fiduciary of a terminated defined contribution plan has the responsibility to locate Missing Participants and, when efforts to communicate with a Missing Participant fail to secure a distribution election, distribute the account balance into a federally-insured bank account in the name of the missing participant or, in certain states, escheat the account balance to a state unclaimed property fund. According to the DOL, when trying to locate Missing Participants, plan fiduciaries should: (i) use certified mail; (ii) check related plan and employer records for more up-to-date information; (iii) identify and contact the participant's designated beneficiary (such as, spouse, children and so on) to find updated contact information; and (iv) use free electronic search tools including internet search engines, public record databases, obituaries and social media. Further, if none of the foregoing methods result in locating the Missing Participant, then the plan sponsor must use additional search steps as appropriate, including commercial locator services, credit reporting agencies, information brokers, investigation databases and analogous services that may involve charges.[36]

The ERISA Advisory Council[37] provided recommendations to the DOL in three areas: (i) developing industry best practices, (ii) updating and supplementing guidance addressing Missing Participant issues and (iii) working with other governmental agencies to create a coordinated approach to addressing Missing Participant issues.[38] Specifically, the ERISA Council recommended that the DOL (i) expand FAB 2004-02 and 2014-01 to specify the required steps that should be taken by ongoing plans to satisfy fiduciary duties, and (ii) confirm use of the forfeiture and reinstatement procedure

[36] FAB 2004-02, FAB 2014-01.
[37] Advisory Council on Employee Welfare and Pension Benefit Plans, *Locating Missing and Lost Participants*, November 2013 (https://www.dol.gov/sites/default/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2013ACreport3.pdf).
[38] 2013 ERISA Advisory Council report.

for uncashed benefit checks. As of this writing, the DOL has not responded to any of these recommendations. As a result, many plan sponsors continue to rely on DOL FABs 2004-02 and 2014-01 as the relevant authority on how to address Missing Participants.

While the DOL has made it clear that locating Missing Participants is a fiduciary duty under the Employee Retirement Income Security Act of 1974, as amended (ERISA), plan sponsors have been left without clarity on how often they need to employ various search methods during the life of an ongoing plan. DOL regional offices have been actively examining large plans through a national, large-scale initiative to help deferred vested participants obtain benefits that are reported on their Social Security notices. Through this effort, some plan sponsors have reported that DOL investigators have been finding fiduciary breaches subject to penalties and personal liability where the sponsors have not been sufficiently aggressive in their efforts to locate Missing Participants. Some plan sponsors have reported that DOL investigators have issued findings that plans have inadequate procedures to find deferred vested participants who terminated employment prior to normal retirement age, especially those who are past their required beginning dates (generally age 70½) and must take corrective action. Others have reported that DOL investigators are asking plan sponsors to solicit updated contact information from coworkers of Missing Participants and to send annual notices to participants who reach normal retirement age even though there are no IRS requirements for such notices. The American Benefits Council strongly urged the DOL to issue comprehensive guidance with respect to Missing Participants and cease taking the ad hoc positions that plan sponsors are currently experiencing.[39]

PBGC Guidance on Missing Participants

The PBGC maintains a Missing Participants program for terminated single-employer PBGC-insured defined benefit plans. The PBGC recently issued a final rule on December 22, 2017, expanding and updating its existing Missing Participants program to cover defined contribution plans (PBGC 2017 Final Rule). Plan sponsors that

[39] https://www.americanbenefitscouncil.org/pub/?id=d68a50ca-908c-9e37-d53d-3111689f91ff.

terminate 401(k) and other defined contribution plans can now turn to the PBGC for help in distributing benefits.[40] Under the PBGC 2017 Final Rule, a participant or beneficiary is considered to be missing if: (i) the plan administrator does not know with reasonable certainty the location of the distributee; (ii) under the terms of the plan, the distributee's benefit is to be paid in a lump sum without the distributee's consent, and the distributee has not responded to a notice about the distribution of the lump sum or (iii) under the terms of the plan and any election made by the distributee, the distributee's benefit is to be paid in a lump sum, but the distributee does not accept the lump sum and it remains uncashed for at least 45 days after either the issuance of the check or the check's stale date (Missing Distributee). The PBGC 2017 Final Rule also now defines a "commercial locator service" as "a business that holds itself out as a finder of lost persons for compensation using information from a database maintained by a consumer reporting agency."

The PBGC 2017 Final Rule provides a new voluntary option for defined contribution plans to deal with Missing Distributees when closing out a plan and makes it more likely that Missing Distributees will receive their benefits from terminated plans. Ongoing plans, however, may not turn benefits over to the PBGC for Missing Participants. The PBGC disclosed in its 2017 Annual Report that it has been working on an initiative with the DOL to enable the DOL's Chicago regional office to work with the PBGC database to reunite participants with benefits.[41] The PBGC reported its intention to expand this pilot program. To date, neither the DOL nor the PBGC has issued guidance to sponsors of ongoing qualified plans.

Existing IRS Guidance on Missing Participants

The IRS has addressed Missing Participants in the following four ways. First, Rev. Proc. 2016-51 "Employee Plans Compliance Resolution System" (EPCRS) addressed locating Missing Participants in the context of making corrections to participants and

[40] https://www.federalregister.gov/documents/2017/12/22/2017-27515/missing-participants (Dec. 22, 2017).
[41] https://www.pbgc.gov/sites/default/files/pbgc_advocate_report_2017.pdf

beneficiaries to whom additional benefits are due, but who have not been located after a mailing to the last known address. In this context, the IRS stated:

> In general, such actions include, but are not limited to, a mailing to the individual's last known address using certified mail, and, if that is unsuccessful, an additional search method, such as the use of a commercial locator service, a credit reporting agency, or Internet search tools. Depending on the facts and circumstances, the use of more than one of these additional search methods may be appropriate. A plan will not be considered to have failed to correct a failure due to the inability to locate an individual if reasonable actions to locate the individual have been undertaken in accordance with this paragraph; provided that, if the individual is later located, the additional benefits are provided to the individual at that time.[42]

Second, the IRS addressed Missing Participants in the context of notifying participants in multiemployer plans that are in critical status of benefit suspension. Where notices are returned as undeliverable, as long as the plan sponsor takes steps to contact the individual beyond the initial mailing, the plan sponsor can satisfy the applicable notice requirement. In the example provided in Treas. Reg. Section 1.432(e)(9)-1(5), Example 2, the plan sponsor takes several steps to locate the Missing Participants:

> The plan sponsor contacts the bargaining parties for the plan and the plan administrators of any other employee benefit plans that the plan sponsor reasonably believes may have information useful for locating the missing individuals, and the plan sponsor requests contact information for the missing individuals. The plan sponsor then uses an Internet search tool, a credit reporting agency, and a commercial locator service to search for individuals for whom it was not able to obtain updated information from bargaining parties.[43]

Rev. Proc. 2016-51 and Treas. Reg. Section 1.432(e)(9)-1 set forth guidelines to use a commercial locator service, a credit reporting agency and internet search tools.

Third, Form 5500, Return/Report of Employee Benefit Plans, acknowledges the existence of Missing Participants. Specifically, lines 4l of Schedules H and I of the Form

[42] Rev. Proc. 2016-51, https://www.irs.gov/pub/irs-drop/rp-16-51.pdf.
[43] 26 C.F.R. 1.432(e)(9)-1.

5500 ask, "Has the plan failed to provide any benefit when due under the plan?" This question was added in 2009 but the instructions to the form did not include examples of what constitutes a reportable failure. On July 29, 2016, the IRS issued clarifying instructions that plan sponsors do not need to report unpaid RMDs for Missing Participants if the plan has engaged in reasonable efforts or is in the process or engaging in such reasonable efforts and made reference therein to DOL guidance on terminated plans.[44]

Finally, in response to the lack of clear and coordinated guidance for ongoing plans, on June 7, 2017, the ACT issued a public report of recommendations to the Tax Exempt and Government Entities Division of the IRS (TE/GE), which included a recommendation that the IRS issue guidelines on what steps plan sponsors should take to maintain compliance with the tax qualification requirements where there are Missing Participants.[45] The IRS considered the ACT's request and issued guidance in the form of a field directive to EP examiners, dated October 19, 2017 (TE/GE FD 2017).[46] The IRS directed that:

> For purposes of [Code Section] 401(a)(9), EP examiners shall not challenge a qualified plan for violation of the RMD standards for the failure to commence or make a distribution to a participant or beneficiary to whom a payment is due, if the plan has taken the following steps: (i) searched plan and related plan, sponsor, and publicly-available records or directories for alternative contact information; (ii) used any of the search methods below: a commercial locator service; a credit reporting agency; or a proprietary internet search tool for locating individuals; and (iii) attempted contact via United States Postal Service (USPS) certified mail to the last known mailing address and through appropriate means for any address or contact information (including email addresses and telephone numbers).[47]

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[44] https://www.irs.gov/retirement-plans/clarifications-to-instructions-for-lines-4l-of-schedules-h-and-i-form-5500-and-line-10f-of-form-5500-sf.
[45] Advisory Committee on Tax Exempt and Government Entities (ACT), *Report of Recommendations*, p. 49 (June 7, 2017) (https://www.irs.gov/pub/irs-pdf/p4344.pdf).
[46] TE/GE-04-1017-0033.
[47] *Ibid.*

In addition, the IRS issued another field directive to EP examiners, dated February 23, 2018 (TE/GE FD 2018), providing parallel guidance for sponsors of 403(b) plans (collectively, the "TE/GE Field Directives").[48] The TE/GE Field Directives are helpful as they provide guidance on one aspect of the Missing Participants problem, but the various constituents of the EP Community have expressed the need for further guidance from the IRS.

The EP Subgroup Project

The EP Subgroup took multiple steps to determine the views of the EP Community and to develop its recommendations regarding Missing Participants. The Subgroup solicited background information from personnel in the IRS Office of Employee Plans (EP). Robert S. Choi, Acting Deputy Commissioner of TE/GE and former EP Director, generously made himself and the EP staff available which helped shape the Subgroup's recommendations. Open and informative discussions with staff and managers were conducted. The EP Subgroup appreciates the time and cooperation from the entire EP team including Cathy Jones, Acting Director, Employee Plans, Khin M. Chow, Director of EP Rulings and Agreements, Sean O'Reilly, Acting Director, Employee Plans Examinations, Tom Petit, former Acting Director of EP Examinations, Lisa Beard, former Director of EP Examinations, Mark O'Donnell, Director, Communication and Liaison, William "Buck" Kerr, Manager, Employee Plans Voluntary Compliance, Louis J. Leslie, Technical Adviser, Employee Plans, and Ryan McDonald, Group Manager, EP Determinations.

Finally, the EP Subgroup held discussions with a number of professional groups and associations within the EP Community to assess the concerns and needs of the community. The EP Community described the current landscape as one in which plan sponsors want to maintain compliance with applicable law, but unanimously expressed deep concerns that they need more guidance on how to navigate the challenges that come with having Missing Participants. The EP Community welcomed the guidance

[48] TE/GE-04-0218-0011.

provided by the TE/GE Field Directives. But, even for plan sponsors that invest the time and incur the cost of diligently searching for Missing Participants, more guidance is needed. Further, there are no standard practices in the industry for the frequency or method of conducting searches. There is a pronounced need for coordinated guidance from the DOL, PBGC and IRS for ongoing qualified plans.

III. RECOMMENDATIONS

The EP Subgroup recommends that the IRS expand its field directives to EP examiners and take certain other steps that will help plan sponsors maintain compliance as follows:

1. Expand the scope of the TE/GE Field Directives to apply to plan distributions other than RMDs under IRC Section 401(a)(9) including:

    - Distributions made pursuant to IRC Sections 401(a)(31), 401(a)(14) and 411(a)(11);
    - Corrective distributions under EPCRS pursuant to Rev.Proc.2016-51, such as a refund under IRC Sections 415, 401(k) or 401(m); and
    - Distributions made to Missing Participants where a communication is not returned as undeliverable but the participant failed to respond to or take the requisite action needed to commence such distribution.

2. Modify the TE/GE Field Directives to clarify that if any communication (even if the envelope does not include a check) was returned as undeliverable with no forwarding address, and if the Plan Sponsor is subsequently unable to locate a valid address for such Missing Participant, the requirement under the TE/GE Field Directives to send a certified letter is waived because it would be imprudent to send a certified letter and/or check to a known invalid address.

3. Modify guidance and the instructions to Form 5500, Annual Return/Report of Employee Benefit Plan, to make clear that sponsors should answer lines 4l of Schedules H and I of the Form 5500 question: "Has the plan failed to provide any benefit when due under the plan?" based on the steps outlined in the TE/GE Field Directives. By way of background, prior to 2015, the instructions to Form 5500 did not include examples of what is a reportable failure. In 2015, the IRS clarified its

instructions to explain that a reportable failure includes any unpaid RMDs. Further, the IRS announced in 2016 that plan sponsors do not need to report unpaid RMDs for Missing Participants if the plan sponsor has engaged in reasonable efforts or is in the process of engaging in such reasonable efforts. With the issuance of the recent TE/GE Field Directives, the instructions to Form 5500 should be revised to specify that reasonable efforts will be determined in accordance with the TE/GE Field Directives.

4. Provide guidance and amend the instructions to IRS Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, to establish an automatic waiver from the IRC Section 4974(a) 50 percent excise tax on insufficient RMDs if the plan sponsor has completed all of the steps outlined in the TE/GE Field Directives.

5. Provide guidance and amend the instructions to IRS Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc. to provide direction on when Form 1099-R should be issued with respect to distributions that remain uncashed.

6. Issue a Field Directive to EP examiners confirming that distributions for Missing Participants, as well as uncashed checks, may be forfeited subject to reinstatement pursuant to Treas. Reg. Section 1.411(a)-4(b)(6) and coordinate such guidance with the DOL.

7. Re-open the IRS Letter Forwarding Program under Rev. Proc. 2012-35 for locating Missing Participants because it is more effective to send official letters from the IRS; employees are reluctant to respond to letters from former employers given anxieties about spams, scams and frauds.

8. Provide support to the Office of the Benefits Tax Counsel at Department of Treasury to increase by legislation the dollar threshold under IRC Sections 411(a)(11) and 401(a)(31) to an amount greater than $5,000. In doing so, plan sponsors will have a greater likelihood of being able to make more distributions of vested benefits to

employees following their termination of employment without their consent, before they become Missing Participants.

9. Support the issuance of inter-agency coordinated guidance with Treasury Office of Chief Counsel, the DOL and PBGC as soon as possible.

ADVISORY COMMITTEE ON

TAX EXEMPT AND GOVERNMENT ENTITIES

(ACT)

Exempt Organizations Subgroup

Recommendations Regarding Incentivizing Universal E-Filing for Form 990

Natasha M. Cavanaugh, Project Leader

Cindy Lott

Michael J. Engle

June 7, 2018

RECOMMENDATIONS REGARDING INCENTIVIZING UNIVERSAL E-FILING FOR FORM 990

I. EXECUTIVE SUMMARY

Much has been written about the benefits of electronically filing Form 990, the annual return for tax-exempt organizations (EO). A full litany of benefits that could be realized by the EO sector, the public and the IRS may be found in the 2015 IRS ACT report, which recommended that the IRS proactively encourage e-filing.[49] In the years since the 2015 ACT report, rapid progress has been made toward universal e-filing of Form 990s. For fiscal year 2017, roughly 57 percent of all Forms 990 and 990-EZ were filed electronically. Unfortunately, nearly 200,000 returns are still paper filed. Without universal electronic filing, the goal of machine-readable, digitized data that may be released easily and efficiently into the public domain remains elusive.

With continuously improving technology and an emphasis on open data across all government agencies, all Form 990 series eventually will be filed electronically. Paper returns will be a relic of the past. Nevertheless, the IRS should take steps to speed the transition. All Form 990 filers should be required or, at least, incentivized to file electronically. Short of a legislative change mandating e-filing, a range of possible incentives from the IRS exists. Universal e-filing will save costs, result in more accurate returns, and improve the availability, reliability and transparency of EO data.

II. BACKGROUND

Users of the Form 990

The forms that most tax-exempt organizations must use to comply with the annual information return requirement are the Form 990, Return of Organization Exempt from Income Tax, Form 990-EZ, Short Form Return of Organization Exempt from Income Tax, or Form 990-N, (e-Postcard). Certain tax-exempt organizations are subject to special return filing requirements. For example, private foundations submit their information to the IRS on a Form 990-PF, Return of Private Foundation. Exempt

[49] See, https://www.irs.gov/pub/irs-tege/tege_act_rpt_14.pdf.

organizations separately report their unrelated business income on a Form 990-T, Exempt Organization Business Income Tax Return.

The Form 990 is relied upon by federal and state regulators and various segments of the general public for different purposes.[50] The primary purpose of Form 990 is enforcement of federal tax law and to meet the statutory information return requirement for tax-exempt organizations. State attorneys general and other state officials use Form 990 data primarily for issues of governance and fundraising regulation.

Because the Form 990 includes questions beyond gross income and disbursements, including, exempt activities, officers' compensation, governance and investments, the data are of interest to academics, independent organizations that provide services to the sector, the media and the public. Form 990 filing organizations also use Form 990 data to compare their organization's structure, management, compensation or performance with that of other organizations. Additionally, tax-exempts often use the Form 990 as a communication tool to provide information about their activities to donors, potential donors and the public.[51]

For more detailed information on the various uses and users of Form 990, see the 2015 ACT report.[52]

The Form 990 Filing Requirement

Every organization exempt from taxation under IRC Section 501(a) must file an annual information return, unless an exception applies.[53] The use of the term "information return" is intentional. It is more than a financial snapshot. The information return reveals more about a nonprofit's operations than comparable tax forms do about individuals or private companies. The information return requires information on the organization's

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[50] For more detail on the various users of Form 990, see, 2015 ACT Report: "*The Redesigned Form 990: Recommendations for Improving its Effectiveness as a Reporting Tool and Source of Data for the Exempt Organization Community,*" June 2015.
[51] *Id.*
[52] *Id.*
[53] IRC Section 6033.

governance, activities, compensation and related parties. As explained by the IRS in the information return instructions, “Some members of the public rely on Form 990 or Form 990-EZ as their primary or sole source of information about a particular organization. How the public perceives an organization in such cases can be determined by information presented on its return.”[54]

Many tax-exempt organizations are exempted from filing a Form 990, including, but not limited to, churches, state institutions (including state colleges and universities) and instrumentalities of the United States.[55] Treasury also has the discretion under IRC Section 6033(a)(3)(B) to relieve additional organizations from the Form 990 filing requirements where it determines the filing is not necessary to the efficient administration of the internal revenue laws.[56]

Electronic Filing Requirement

Any organization may file its Form 990 and related forms, schedules and attachments electronically. However, only the smallest exempt organizations and the largest are required to file electronically. Other exempt organizations filing a Form 990 may choose, but are not required, to e-file.

1. Small Organizations: “Electronic Postcard” Filing

IRC Section 6033 requires tax-exempt organizations with gross receipts of $50,000 or less to file electronically Form 990-N.[57] Although Form 990-N must be filed online, small organizations have the option of filing, either electronically or on paper, a Form 990 or Form 990-EZ.

[54] Form 990 instructions.
[55] IRC Section 6033(a); Treas. Reg. Section 1.6033-2(g).
[56] IRC Section 6033(a)(3)(B).
[57] IRC Section 6033(i).

For fiscal year 2017, more than 600,000 Form 990-Ns were e-filed. Yet, roughly 66,500 Form 990 and 990-EZ returns were paper filed with gross receipts of $50,000 or less and presumably eligible to e-file Form 990-N.

2. Large Organizations: Electronic Filing of the Form 990

IRC Section 6011(e) authorizes the Secretary of the Treasury to prescribe regulations providing for standards for the e-filing of returns. The Secretary is not allowed to require any taxpayer to file a return electronically unless the taxpayer is required to file at least 250 returns during a calendar year.[58] The Secretary is also instructed to consider the ability of the taxpayer to comply with the reasonable cost of e-filing[59] and is further authorized to implement procedures to provide for "the payment of appropriate incentives for electronically filed returns."[60]

The regulations that were promulgated under IRC Section 6033 in 2005 narrow the category of exempt organizations that are required to file a Form 990 electronically by adding an additional $10 million asset threshold; that is, an exempt organization must file its Form 990 electronically only if it is required to file at least 250 returns in a calendar year and has total assets exceeding $10 million[61] The preamble to these regulations states that exclusion of certain exempt organizations with total assets of less than $10 million was to "eliminate the potential burden of electronic filing on small businesses that may not be able to comply at a reasonable cost."[62] Interestingly, this same concern is not bestowed on private foundations. Private foundations, unlike public charities, are subject only to the 250 returns threshold. Once this threshold is met, a private foundation must electronically file a Form 990-PF regardless of asset size.[63]

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[58] IRC Section 6011(e)(2)(A). To determine the 250-return requirement, returns of any type are counted, including information returns, income tax returns, employment tax returns and excise tax returns. Treas. Reg. Section 301.6033-4(d)(3).
[59] IRC Section 6011(e)(2)(B).
[60] IRC Section 6011(f).
[61] Treas. Reg. Section 301.6033-4(f).
[62] I.R.B. 2005-10 (March 7, 2005). In promulgating the regulations, however, the Department of Treasury encouraged all organizations to adopt electronic filing as soon as feasible even if not required by the regulations to do so.
[63] Treas. Reg. Section 301.6033-4.

Form 990 in Machine-Readable Format

One of the many benefits of electronically filed 990s is the ability to more easily convert the data to open formats. The Aspen Institute has devoted significant resources to studying the Form 990 and its data, the results of which it published in "Information for Impact: Liberating Nonprofit Sector Data."[64] The Aspen Institute report promotes many benefits of open Form 990 data, including increasing the transparency for nonprofit organizations, making it easier for state and federal authorities to detect fraud, spurring innovation in the nonprofit sector and making the data useful for researchers, advocates, entrepreneurs and technologists, as well as nonprofit organizations that do not have the resources to use the data from image files.[65]

In the summer of 2016, the IRS announced that the publicly available data on electronically filed 990s would be available for the first time in a machine-readable format through Amazon Web Services (AWS).[66] The publicly available data does not include donor information or other personally identifiable information. The launch of this effort was a huge step in ensuring that better, more usable data about the nonprofit sector is available to the public. As noted by then IRS Commissioner John Koskinen, "The publicly available information on the Form 990 series is vital to those interested in the tax-exempt community."[67]

Only e-filed Forms 990 are available in machine-readable format. Paper returns are available only as image files and for purchase from the IRS on DVD. As a result,

[64] Novek, Beth and Goroff, Daniel, "Information for Impact: Liberating Nonprofit Sector Data", The Aspen Institute (2nd edition) 2013; *available at* www.aspeninstitute.org/publications/information-impact-liberating-nonprofit-sector-data/.
[65] *Id.*
[66] IR-2016-87, June 16, 2016.
[67] *Id.*

roughly 43 percent of all Forms 990 and 990-EZ are *not* available in machine-readable format.[68]

Accounting Firm Practices

Organizations that engage paid preparers are more likely to e-file. In fiscal year 2017, 77 percent of the Forms 990 and 990-EZ prepared and filed with paid preparers were electronically filed. In contrast, only 14 percent of the Forms 990 and 990-EZ prepared and filed without paid preparers were electronically filed. Accounting firms prefer to e-file for the following reasons:

1. More efficient process that saves time and cost for the taxpayer and the paid preparer;
2. Electronically filed Forms 990 and 990-EZ are more complete and have less errors than paper filed returns because electronically filed returns must be complete before being accepted for electronic filing;
3. Electronically filing Forms 990 and 990-EZ reduces the possibility of human error; and
4. The receipt of an electronic confirmation that Form 990 or Form 990-EZ was accepted or rejected by the IRS.

Although accounting firms prefer to e-file, there are circumstances that require Forms 990 and 990-EZ to be paper filed. For instance, if an organization changes its name or amends a Form 990 or 990-EZ, those returns must be paper filed because the IRS is unable to process these returns electronically.

[68] Note that even those data that are available in machine-readable form are not necessarily released in a form useful to the public, including skilled academics. In 2017, the Aspen Institute and its data coalition partners Guidestar, Urban Institute, Indiana University's Lilly Family School of Philanthropy, Charity Navigator, Syracuse University, Johns Hopkins University, George Washington University and American University, held their first "datathon" for creating usable digitized data from the information now publicly available through the IRS on the Amazon Web Services platform. See https://www.aspeninstitute.org/blog-posts/aspen-institutes-program-philanthropy-social-innovation-psi-hosts-nonprofit-datathon/.

Lessons Learned from Abroad

As a point of comparison, albeit limited, both the Australian and New Zealand governments have had good experiences with incentivizing charities to electronically file both registrations and returns. Interviews with charities regulators in both countries reveal that when government across the federal landscape institutes electronic filing and communication, not only for exempt organizations but for many or all federal interactions, charities have responded well.

Over the last five to eight years, Australia has established in one sustained initiative an online platform for Australian charities registration and filing -- the Australian "Charities Passport" system.[69] In New Zealand, there was a major push for the entire federal government to use electronic filing and communication, so charities were simply one of many sectors to transition from paper to electronic interactions with the government. Of note, of course, are the much smaller and more discrete populations of charities in these two countries. Australia has approximately 55,000 registered charities[70] and New Zealand has less than 30,000.[71] In contrast, the United States has roughly 1.5 million tax-exempt organizations.[72]

Australia incentivized e-filing in several ways. Some of their actions, however, could be considered simple encouragement rather than incentivization. First, organizations that registered electronically were listed on the official government website as a registered organization within 15 days of electronically filing appropriate registration paperwork; those organizations that registered on paper were officially listed in about 28 days. Such quick and public acknowledgement of an organization's registration with the government allows organizations to pursue fundraising opportunities sooner. Notably, the Australian government did not charge a fee differential based on e-filing versus paper filing. Second, the Australian government tracked which organizations did not e-file and sent

[69] See http://www.acnc.gov.au/ACNC/About_ACNC/Redtape_redu/Charity_Passport/ACNC/Edu/Charity_Passport.aspx.
[70] https://acnc.gov.au/ACNC/FAQs/FAQ_Are_there_too_many_charities.aspx#Q2.
[71] See https://charities.govt.nz/.
[72] See http://nccs.urban.org/frequently-asked-questions.

them letters, specifically noting that the government was aware the organization elected to paper file and informing the organization that e-filing was more efficient, easier and quicker than paper filing. Third, the Australian charities regulators set expectations publicly that electronic filing was the default, but acknowledged that there would never be 100 percent participation for e-filing. If an organization wanted to paper file, the government would send them the form upon request.

In New Zealand, electronic filing was part of a larger campaign to have residents use online systems in various contexts across government offices. Today, 95 percent of all filings by charities in New Zealand are submitted online. New Zealand embedded incentives into their filing system to encourage such electronic filing, including:

- The country charges a higher fee for paper filings than it does for electronic filing;
- If submitted digitally, information is released to the public almost immediately, as opposed to a delay as is true of paper documents;
- The country has an online system that provides pre-population of data, which makes annual filings more efficient over time; and
- New Zealand has developed an authentication system so there is shared access among an organization's designated representatives to file electronically within a shareable document.

To support an enabling environment, the country made a large push for broadband to be available in even the most remote areas. Overall, New Zealand has found that ease of use is the best incentive.

Hurdles

1. Security

Form 990 filers often cite data security as a major deterrent to e-filing. Even though all data included on Form 990 and 990-EZ is available to the public (save Schedule B information), exempt organizations are concerned about protecting their donors' information. The IRS is required by law to maintain the confidentiality of donor information. However, because of highly publicized security breaches and general technology failures at the IRS, the public questions the security of IRS systems. As

indicated in the 2015 IRS ACT report, the IRS must ensure that its online systems are as secure as possible to maintain confidentiality of donor information and to avoid data breaches. Discussions with accounting firms and taxpayers reveal that if exempt organizations were more confident about the security of the IRS online systems and the IRS's ability to maintain confidentiality, organizations might be more willing to file electronically the Form 990 and 990-EZ.

2. Technology

The "digital divide" is another rationale for maintaining the paper filing option. There still exists some concern that small organizations, particularly those in rural areas, might not have affordable, quality access to the internet.[73] Fortunately, the digital divide is dwindling and technology is rapidly evolving to provide easy-to-use online platforms for filings. As noted in President Obama's Fiscal Year 2016 Revenue Proposals, requiring electronic filing is unlikely to impose a large burden on tax-exempt organizations, since they generally maintain financial records in electronic form and either hire a tax professional or self-prepare returns using tax preparation software that enables electronic filing.[74] The fact that more than 600,000 Forms 990-N were e-filed instead of paper filing a Form 990 is a telling sign that even the smallest organizations have the ability to e-file.

III. RECOMMENDATIONS

Government-Wide Effort is Needed

As far back as 2013, exempt organizations specialists urged Congress to pass a mandatory electronic filing law for exempt organization returns and suggested new processes for exempt organization filings, including electronic filings to a third-party

[73] Perrin, Andrew, "Digital Gap Between Rural and Nonrural America Persists," Pew Research Center (May 19, 2017).
[74] Department of Treasury, General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals (Feb. 2015), available at https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf.

platform in the form of "open," machine-readable data.[75] In 2017, GuideStar, Foundation Center and Aspen Institute's Nonprofit Data Project submitted written comments to the U.S. House Ways and Means Committee in support of a statutory requirement for mandatory electronic filing as part of IRS information technology modernization.[76] In addition, this same coalition submitted written recommendations to the Treasury Department and the IRS for the 2017-2018 Priority Guidance Plan Notice 2017-28, including a recommendation to continue releasing electronically filed data (Forms 990), as well as changing requirements on the 990 return to specify types of federal government funding.[77] Both sets of public comments to the Ways and Means Committee and the IRS referenced the 2015 IRS ACT report (EO Subgroup) on electronic filing. The IRS has made progress as evidenced by its public release of electronically filed 990 data. Despite this progress, over 40 percent of Form 990 and 990-EZ returns are paper filed and, thus, unavailable in a machine-readable format.

The U.S. is a member of the Open Government Partnership, a group that was launched internationally by dozens of countries in 2011 "to provide an international platform for domestic reformers committed to making their governments more open, accountable, and responsive to citizens,"[78] including "e-government," which is a fundamental aspect of these goals. The call to action to modernize IT for the U.S. federal government generally has been sustained and is emphasized again in "The Report to the President on Federal IT Modernization, 2017."[79] The upgrade of all federal IT security, cloud capabilities and mandatory use of machine-readable data through electronic filing certainly will create an environment conducive to e-filing for exempt organizations. In February 2018, a bipartisan group of Congress members introduced the Grant

[75] See, Information for Impact: Liberating Nonprofit Sector Data, *supra* note 15.
[76] *Statement in Support of Mandatory Electronic Filing/Open Form 990 Data and Technical/Communications Improvements*, submitted on behalf of GuideStar and the Nonprofit Data Project of the Aspen Institute (October 4, 2017).
[77] *Public Comment on the 2017-2018 Priority Guidance Plan*, submitted by GuideStar, Foundation Center and the Nonprofit Data Project of the Aspen Institute (June 1, 2017).
[78] https://www.opengovpartnership.org/
[79] *Report to the President on Federal IT Modernization* (December 2017); available at https://www.scribd.com/document/367105969/Federal-IT-Modernization-Report#download.

Reporting Efficiency and Agreements Transparency (GREAT) Act (H.R. 4887), which intends to standardize and modernize all grantee reports for federal grants, including requirements for structured and machine-readable data. If enacted, the GREAT Act surely will impact directly the many nonprofits that are federal grantees. Similarly, the House passed several IT modernization bills in the wake of the 2017 tax filing deadline being delayed by a day because of an outage in the IRS payment application. One such bill is the 21st Century IRS ACT, which would codify the IRS Chief Information Officer role, which would be responsible for the development, implementation and maintenance of IT at the IRS.

These efforts, from the broad quest to modernize federal government to specific calls for open data for exempt organizations' filings, provide an ecosystem for mandatory electronic filing. The IRS should support government-wide efforts to provide open data and IT modernization. As other countries have found, once efforts are made across the entire federal landscape for digitized data requirements, machine-readable data and a continued movement toward open data, the exempt organizations sector will be swept up in the same swell of electronic evolution.

Mandate Electronic Filing

Based on the ACT's informal conversations with various stakeholders, there appears to be overwhelming support for e-filing of the Form 990 series returns. We recommend that IRC Sections 6011(e) and 6033 be amended to make electronic filing of the Form 990 series mandatory for all tax-exempt organizations.[80] We recognize that such a change requires Congressional action. Nevertheless, as recommended in the 2015 ACT report, the IRS should encourage and support a statutory fix.

[80] Removing the 250-return threshold from the IRC (even with the $10 million asset threshold remaining) would require more entities to e-file. But, this change alone would not achieve universal e-filing.

Eliminate the $10 Million Asset Threshold

Until e-filing of the Form 990 series is mandatory through an amendment to the IRC, the IRS should encourage the Department of Treasury to eliminate the $10 million in assets threshold on mandatory electronic filing that is set forth in the regulations under IRC Section 6033 and to add this action item to the Priority Guidance Plan. IRC Section 6011(e) states that taxpayers may not be required to electronically file unless they are required to file at least 250 returns during a calendar year. The statute does not place a minimum asset requirement on this restriction. In 2005, when the Department of Treasury promulgated the electronic filing regulations, it added the $10 million limitation for Form 990 filers to eliminate a perceived potential burden to smaller organizations that may not be able to comply at a reasonable cost with e-filing. In 2018, this perceived burden may not be eliminated in all cases, but most exempt organizations should have the ability, through staff, volunteers and advisors, to e-file the Form 990. Thus, to increase e-filing, the IRS should encourage the Department of Treasury to eliminate the $10 million threshold for mandatory e-filing, which is not required by the IRC.

Encourage and Provide Incentives for Voluntary E-Filing

Treasury is authorized to implement procedures to provide for the payment of appropriate incentives for electronically filed returns.[81] The IRS should support Treasury in considering measures to provide incentives for organizations to voluntarily e-file Form 990 and 990-EZ. For example, Treasury should consider allowing organizations that e-file to be exempt from filing Schedule B. If this is not feasible, then Schedule B should be eliminated for all Form 990 filers. Eliminating Schedule B would reduce concerns tax-exempt organizations have regarding overall security and confidentiality of donor information. More organizations would likely elect to e-file if donor information were not

[81] IRC Section 6011(f)(2).

required. This is just one option. Treasury, with IRS support, should consider other appropriate incentives for electronically filed returns.

Prioritize the Development of Online Accounts for Organizations

The IRS should prioritize the adoption of online accounts that can accommodate free e-filing for tax-exempt organizations. Only 14 percent of self-prepared Forms 990 and 990-EZ are e-filed. For organizations that self-prepare, the lack of freely available software is a major impediment to e-filing. The IRS has taken steps to create individual online accounts. However, it has been slow to do so for organizations. One hurdle to creating online accounts for organizations is ensuring secure and authorized account access. Though, in recent years, the IRS has made great strides in e-authentication -- individual users identifying themselves to the system and their subsequent re-authentication.

The FATCA Online Registration System serves as a good example. The Foreign Account Tax Compliance Act (FATCA), which was passed as part of the HIRE Act, generally requires that foreign financial institutions and certain other non-financial foreign entities report on the foreign assets held by their U.S. account holders or be subject to withholding on certain payments.[82] The FATCA registration system is a one-stop registration website that is available 24 hours a day, seven days a week and contains features that provide online communications and efficient delegation of authority for purposes of online registration. This gives financial institutions the flexibility to manage information among branches and related entities. The IRS touts that FATCA registration can be accomplished most efficiently and effectively through the online registration process, which avoids the need to print, complete and mail paper forms. The same would be true of an online account system for tax-exempt organizations.

[82] See, Hiring Incentives to Restore Employment Act, 26 U.S.C. Section1471.

We recognize that online accounts might require resources to update IRS systems and platforms and to train IRS personnel. However, the FATCA system provides the necessary building blocks and serves as a model for the implementation of online accounts for tax-exempt organizations. In addition, the immediate cost savings and efficiencies that the IRS would reap from an online account system justify the investment.

ADVISORY COMMITTEE ON

TAX EXEMPT AND GOVERNMENT ENTITIES

(ACT)

Indian Tribal Government Subgroup

Recommendations Regarding IRS Sharing of Taxpayer Information with Tribal Government Tax Programs

Marcelino R. Gomez, Project Leader

Jean Swift

June 7, 2018

RECOMMENDATIONS REGARDING IRS SHARING OF TAXPAYER INFORMATION WITH TRIBAL GOVERNMENT TAX PROGRAMS

I. EXECUTIVE SUMMARY

Internal Revenue Code (IRC) Section 6103 generally prohibits the disclosure of taxpayer information.[83] There are several exceptions to the disclosure prohibition rule identified in IRC Section 6103 that allow for the disclosure of taxpayer information. One disclosure exception authorizes the IRS to share tax information by entering into agreements with governmental agencies for tax administration purposes.[84] IRS information sharing programs provide for an efficient utilization of limited government resources through partnerships between the IRS and federal, state and municipal governmental agencies. The goal of these programs is to enhance voluntary compliance with tax laws. This includes facilitating the exchange of taxpayer data, leveraging resources, providing assistance to taxpayers to improve compliance and communications and identifying and reporting information on emerging tax administration issues.

Currently, the IRS can only enter into intergovernmental agreements with states and municipalities because IRC Section 6103(d)(1) does not specifically mention tribes. This failure to include tribal governments is a problem for two reasons. First, it means that that a tribal government is unable to enter into an agreement directly with the IRS to allow a tribal tax administration agency to either share information with, or receive information from, the IRS. All taxpayers subject to tribal taxes are also subject to federal taxes of various kinds. It would be mutually beneficial to the tribal tax administrator and the IRS to be able to share information related to the reporting of mutual taxpayers. This shared information would allow for the tax administrators to verify compliance with the tax requirements of both governments.

Second, state tax agencies are not allowed to share information with tribal tax administrators if they received that information from the IRS pursuant to their own agreements under IRC Section 6103(d)(1), as the tax sharing agreements between the

[83] IRC Section 6103(a).
[84] IRC Section 6103(d)(1).

IRS and states prohibit either side from revealing to any third-party information obtained pursuant to the agreement. Even in situations where there is an intergovernmental agreement between a tribal government and a state, the state is unable to provide information to the tribal government, because it is shared information they received from the IRS pursuant to an intergovernmental agreement under IRC Section 6103(d)(1). The ability to enter into an agreement with the IRS would enhance a tribal government's ability to effectively and efficiently administer its tax program.

Tribal governments understand there must be a written agreement in place between the IRS to begin the sharing process. Tribal governments also recognize that significant safeguards must be in place before information can be shared. A congressional amendment of IRC Section 6103(d)(1) adding Indian tribal governments is required to allow for the sharing of taxpayer information with tribal tax administrators just like the IRS does with states and municipalities. The Treasury Department has recognized the mutual benefits to compliance activity that information sharing will provide. An amendment of IRC Section 6103(d)(1) has been consistently recommended by the Department of the Treasury since Fiscal Year 2010.[85]

However, some information sharing could occur without a legislative amendment of the IRC. This taxpayer information sharing could be handled administratively under IRC Section 6103(l)(7). That section requires the Social Security Administration and the IRS to disclose taxpayer information to "any Federal, State, or local agency administering" identified social service programs to determine eligibility and the correct amount of benefit under the program. Taxpayer information should be available to agencies administering specified needs-based programs to allow for more accurate determinations of both eligibility for benefits and the amount of benefit properly available. So, in the absence of a clear exclusion of an Indian tribal government agency

[85] Department of the Treasury, General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals, https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2010.pdf, Facilitate Tax Compliance with Local Jurisdictions at p.102.

administering identified social service programs, the IRS is allowed to share the taxpayer information.

The ITG Subgroup makes recommendations that focus on practical ways to allow for the sharing of tax information among the federal government, tribal governments and state governments to improve tax administration in Indian Country.

II. BACKGROUND

Indian tribal governments are distinct political communities, having territorial boundaries, within which their authority is exclusive, and having a right to all the lands within these boundaries, which is not only acknowledged, but guaranteed by the United States.[86] The United States has a trust responsibility to each federally recognized tribal government that includes the protection of the sovereignty of each tribal government. Congress, through statutes, treaties and the exercise of administrative authorities, has recognized the self-determination, self-reliance and inherent sovereignty of Indian tribes. Indian tribes possess the inherent authority to establish their own form of government.[87] The tribal right of self-government flows from the inherent sovereignty of Indian tribes and nations. The United States recognizes a special government-to-government relationship with Indian tribes, including the right of the tribes to self-governance, as reflected in the United States Constitution, treaties, federal statutes and in the course of dealings of the United States with Indian tribes.[88]

The power to tax is an essential attribute of Indian sovereignty because it is a necessary instrument of self-government to raise revenues for its essential services. “[I]t derives from the tribe's general authority, as sovereign, to control economic activity within its jurisdiction, and to defray the cost of providing governmental services by requiring contributions from persons or enterprises engaged in economic activities within that

[86] *Worchester v. Georgia*, 31 U.S.515, 557, 559, 561 (1832).
[87] Indian Tribal Justice Support Act, 25 U.S.C. §§ 3601-3631 (2012).
[88] Indian Self-Determination Act of 1994, Pub. L. No. 103-413, 108 Stat. 4250, 4270-77 (1994).

jurisdiction."[89] There are 573 federally recognized Indian tribes in the United States.[90] A large number of these tribal governments have enacted tax statutes and created tax programs to administer the enacted taxes. Tribal governments look to these taxes to fund a broad range of essential governmental programs, services and activities, including economic development, community development, human resources, natural resources, public safety, health services, social services, education, road construction and maintenance, legislative, and judicial services.

IRC Section 6103 governs the disclosure of taxpayer information by the IRS. It generally prohibits the disclosure of taxpayer information.[91] There are several enumerated exceptions to the disclosure prohibition rule identified in IRC Section 6103. Some of these exceptions include disclosure to state tax officials and state and local law enforcement agencies,[92] disclosure to State audit agencies,[93] reimbursement to state and local law enforcement agencies,[94] disclosure for combined employment tax reporting,[95] disclosure to persons having material interest,[96] disclosure to Committees of Congress,[97] disclosure to the President and certain other persons,[98] disclosure to certain federal officers and employees for purposes of tax administration,[99] disclosure to certain federal officers and employees for administration of federal laws not relating to tax administration,[100] statistical use,[101] disclosure of certain returns and return information for tax administration purposes,[102] and disclosure of returns and return information for purposes other than tax administration.[103]

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[89] *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 137 (1982).
[90] An Introduction to Indian Nations in the United States, at http://www.ncai.org/about-tribes.
[91] IRC Section 6103(a).
[92] IRC Section 6103(d)(1)
[93] IRC Section 6103(d)(2)
[94] IRC Section 6103(d)(4).
[95] IRC Section 6103(d)(5).
[96] IRC Section 6103(e).
[97] IRC Section 6103(f).
[98] IRC Section 6103(g).
[99] IRC Section 6103(h).
[100] IRC Section 6103(i).
[101] IRC Section 6103(j).
[102] IRC Section 6103(k).
[103] IRC Section 6103(l).

Disclosure to State Tax Officials

One disclosure exception authorizes the IRS to share tax information by entering into agreements with governmental agencies for tax administration purposes.[104] IRS information sharing programs provide for an efficient utilization of limited government resources through partnerships between the IRS and federal, state and municipal governmental agencies. The goal of these programs is to enhance voluntary compliance with tax laws. This includes facilitating the exchange of taxpayer data, leveraging resources, providing assistance to taxpayers to improve compliance and communications, and identifying and reporting information on emerging tax administration issues.

Currently, the IRS can only enter into intergovernmental agreements with states and municipalities, because IRC Section 6103(d)(1) does not specifically name tribes. This failure to explicitly include tribal governments in IRC Section 6103(d) is problematic for two reasons. First, it means that that a tribal government is unable to enter into an agreement directly with the IRS to allow a tribal tax administration agency to either share information with, or receive information from, the IRS under IRC Section 6103(d)(1). All taxpayers subject to tribal taxes are also subject to federal taxes of various kinds. It would be beneficial to both the tribal tax administrator and the IRS to be able to share information related to the reporting of mutual taxpayers. This shared information would allow for the tax administrators to verify compliance with the tax requirements of both governments.

Second, state tax agencies are not allowed to share information with tribal tax administrators if they received that information from the IRS pursuant to their agreements under this section. The tax sharing agreements between the IRS and states prohibit either side from revealing to any third party any information obtained under the agreement. Even in situations where there is an intergovernmental agreement between

[104] IRC Section 6103(d)(1).

a tribal government and a state in place, the state is unable to provide information to the tribal government, because it is shared information they received from the IRS pursuant to an intergovernmental agreement under IRC Section 6103(d)(1). Indian tribal governments have worked cooperatively with their respective state governments on a sovereign-to-sovereign basis. They entered into numerous compacts and agreements that clearly demarcate their respective authority over a variety of subject areas, including tax administration, land use and zoning, natural resource management, law enforcement, health and social services. This cooperation has focused on the coordination of tax administration and other activities and the sharing of information on a regular basis. Some tribal governments have tax sharing agreements with numerous states in place.[105] These agreements have proven to be very useful in the administration and collection of the appropriate taxes. By sharing information, the states and the tribes can ensure that a taxpayer pays the appropriate tax to the appropriate sovereign. This sharing process would be much more effective if the IRS was also a part of the sharing process.

The ability to enter into an agreement with the IRS would greatly enhance a tribal government's ability to effectively and efficiently administer its tax program. Tribal governments understand there must be a written agreement in place between the IRS to begin the sharing process. Tribal governments also recognize that significant safeguards must be in place before information can be shared. The IRS provides guidance to ensure that the policies, practices, controls and safeguards employed by recipient agencies, agents or contractors adequately protect the confidentiality of federal tax information.[106] Tribal governments understand that there are significant burdens and expenses to comply with these safeguard policies. For that reason, tribal governments

[105] The Navajo Tax Commission has tax information sharing agreements with the states of Arizona, New Mexico Utah, Texas and California in place. History of the Navajo Tax Commission at www.tax.navajo-nsn.gov.
[106] IRS Publication 1075 at Section 1.2.

like states and municipalities should have the option to elect whether to participate in the taxpayer information sharing program.[107]

Some tribal tax administrators have approached the IRS to look at whether the IRS can make an internal determination that it is acceptable to enter into an agreement with a tribal government under IRC Section 6103(d)(1). Pursuant to this request, the IRS has determined that it cannot be handled administratively. The IRC simply does not provide for agreements with tribes, and there is no way to assume that the use of the word "states" in IRC Section 6103(d)(1) is intended to include Indian tribal governments as well. Tribes are not states and cannot be construed as such. Therefore, the authorization for the IRS to enter into an information sharing agreement with a tribal government under IRC Section 6103(d)(1) will require amendment of the IRC. The Treasury Department has recognized the mutual benefits to compliance activity that information sharing will provide. An amendment of IRC Section 6103(d)(1) has been consistently recommended by the Department of the Treasury since Fiscal Year 2010.[108]

Disclosure to any Federal, State or Local Agency Administering Identified Social Service Programs

There is one situation, where the sharing of taxpayer information would not require an amendment of the IRC and could be handled administratively under IRC Section 6103(l)(7). That section requires the Social Security Administration and the IRS to disclose taxpayer information to "any Federal, State, or local agency administering" identified social service programs to determine eligibility and the correct amount of benefits under the program.[109] Neither IRC Section 6103 (including specifically IRC Section 6103(l)(7)) nor the Treasury Regulations promulgated thereunder define "local"

[107] Comments from participants attending the National Intertribal Tax Alliance Conference September 11, 2017.
[108] Department of the Treasury, General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals, available at https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2010.pdf, Facilitate Tax Compliance with Local Jurisdictions at p. 102.
[109] IRC Section 6103(l)(7)(B).

or “local agency.” No definition of “local agency” can be found in the IRC or Treasury Regulations. Treasury Regulations have never been issued under IRC Section 6103(l)(7). The legislative history indicates that IRC Section 6103(l)(7) was expanded in 1984 because “Congress believed that wage and nonwage information should be available to agencies administering specified needs-based programs . . . to make more accurate determinations of both eligibility for benefits and the amount of benefits properly available.”[110] The Congressional intent of Section 6103(l)(7) was specifically to help agencies make “more accurate determinations of both eligibility for benefits and the amount of benefits properly available.[111] There is nothing in the legislative history of IRC Section 6103(l)(7) that suggests tribes should be excluded from treatment as a local agency.

The IRS can and should treat a tribal government entity administering identified social programs to determine eligibility and the correct amount of benefits under the program as a local agency under IRC Section 6103(l)(7). This treatment would not require an amendment of the IRC but can be performed administratively by the IRS.

III. RECOMMENDATIONS

1. The ITG Subgroup recommends that the IRS provide support for an amendment to IRC Section 7871 to treat Indian Tribal Governments like states for purposes of IRC Section 6103. This would allow the IRS and Tribal Governments to enter into taxpayer information sharing agreements under IRC Section 6103(d)(1), which would be most beneficial to both parties in the effort to ensure compliance with the tax laws of both governments. The ITG Subgroup also supports the recommendation of the Department of the Treasury to treat Indian Tribal Governments as states for information sharing

[110] Legislative History of the Deficit Reduction Act of 1984, P.L. 98-369, at 1218 (1984).
[111] Legislative History of the Deficit Reduction Act of 1984, P.L. 98-369, at 1218 (1984).

purposes.[112] The ITG Subgroup requests that the IRS formally provide its support to the Department of Treasury to move this legislative action forward at the first opportunity.

2. The ITG Subgroup recommends the IRS treat a tribal government entity administering identified social programs to determine eligibility and the correct amount of benefits under the program as a local agency, and provide information sharing as required by IRC Section 6103(l)(7). This IRS determination would not require an amendment of the IRC, but can be an administrative determination by the IRS.

[112] Department of the Treasury, General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals, https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2010.pdf, Facilitate Tax Compliance with Local Jurisdictions at p. 102.

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ADVISORY COMMITTEE ON

TAX EXEMPT AND GOVERNMENT ENTITIES

(ACT)

Tax-Exempt Bond Subgroup

Recommendations to Encourage Self-Compliance by Issuers of Tax-Advantaged Obligations

Bill Johnson, Project Leader

David Danenfelzer

June 7, 2018

RECOMMENDATIONS TO ENCOURAGE SELF-COMPLIANCE BY ISSUERS OF TAX-ADVANTAGED OBLIGATIONS

I. EXECUTIVE SUMMARY

The topic of increasing compliance and self-reporting by issuers/conduit borrowers (Issuers) of tax-advantaged obligations[113] has surfaced as an issue many times over the past twenty years. The general theme of each of these proposals, from both the National Association of Bond Lawyers (NABL), the Tax-Exempt Financing Committee of the American Bar Association Tax Section, and several ACT Tax-Exempt Bond Subgroups (TEB Subgroup) has been to create a structure that incorporates subjective factors, defines a penalty structure and is not overly burdensome to Issuers or the IRS.

The current TEB Subgroup's project is to provide a conceptual framework for revisions to the current IRS TEB Voluntary Compliance Agreement process and the TEB Streamlined Voluntary Compliance Agreement process (jointly referred to as TEB VCAP) that provides:

- An easily determinable payment amount to resolve violation (Resolution Amount) that is acceptable from both the Issuer's and the IRS's standpoint;
- Closure on a violation;
- Minimal cost to the Issuer; and
- Frees up the IRS to deal with unusual situations.

As a result of Indian Tribal Governments and Tax-Exempt Bonds shrinking workforce and increasing workload, the volume of small and infrequent Issuers, and a decline in the individual and corporate tax rates, the fear of an examination of a particular issue (and the resulting potential liability and penalties) may not be enough to ensure Issuer post issuance compliance. The IRS needs to encourage self-policing by Issuers to self-correct and self-report violations. To entice Issuers to implement compliance programs and correct violations, the current TEB VCAP program needs to be revised to provide sufficient incentives to encourage Issuers to participate. The correction options must be

[113] Treas. Reg. Section 1.150-1(b).

simple, cost-effective and encourage self-compliance by providing an economic incentive for Issuers to actively monitor and correct violations.

II. BACKGROUND

Tax-Advantaged Obligation Compliance

In general, Issuers of tax-advantaged obligations do not pay tax. Holders of tax-exempt obligations generally do not pay tax on interest income from the obligations pursuant to IRC Section 103. Holders of certain types of bonds receive tax credits[114] pursuant to IRC Sections 54A and 54AA. However, Issuers must remit any profit realized from borrowing at tax-exempt rates and investing unspent proceeds at taxable rates, known as arbitrage.

The Treasury has defined tax-advantaged obligation requirements in three major areas:

- Spending the tax-advantaged obligation's proceeds on the stated purpose of the issue (document retention).
- Having to remit any profit on the investment of unspent tax-advantaged proceeds (rebate and yield restriction – referred to as rebate).
- Limiting the private use of assets financed with certain tax-advantaged bond proceeds to permitted threshold amounts (acceptable private business use).

The Internal Revenue Manual (IRM) defines "Voluntary Compliance" to include post issuance diligence and resolving noncompliance on a timely basis. This general information for Issuers of tax-advantaged obligations includes:

- General post issuance compliance responsibilities
- Self-correction of violations
- Voluntary Closing Agreement Program (TEB VCAP)

[114] In some cases, rather than provide a tax credit to the obligation holder, an Issuer can elect to receive a direct subsidy from the U.S. Treasury and interest on the obligation is taxable to the holder.

Issuers are required to monitor each of these areas for compliance. If the Issuer discovers a violation within a prescribed time period, they may self-correct these violations through what are referred to as remedial actions. If these remedial actions are not initiated and reported within a prescribed time period, the Issuer can correct the violation through the self-reporting TEB VCAP.

The IRS uses audits to test and encourage compliance in the tax-advantaged obligation area.

Evolution of TEB VCAP

In May 1997, the IRS announced a formal tax-exempt bond closing agreement program.[115] Violations of IRC Section 103 and related provisions that could not be remedied under then-existing remedial action provisions or other tax-exempt bond closing agreement programs contained in regulations or other published guidance could be resolved by entering into a closing agreement under the TEB VCAP. Notice 2001-60 provided additional information on the scope and procedures for requesting a closing agreement under the TEB VCAP. Notice 2008-31 modified and superseded Notice 2001-60 by incorporating tax credit bonds into the TEB VCAP and by referring to IRM 7.2.3 for specific information required for TEB VCAP submissions.

In June 2000, NABL appointed a special task force – The Task Force on Alternative Dispute Resolution (Task Force). The Task Force issued its suggestions for improvement in the enforcement programs in September 2004. That report outlined five basic principles for reform:

- As a general rule, the Issuer, not the bond holder, should pay any required penalty when a mistake or violation occurs.
- The program should cover all violations.

[115] Rev. Proc. 97-15, 1997-1 C.B 635.

- The program should specify the maximum penalty for as many classes or types of violations as possible so that the Issuers will be encouraged to voluntarily report noncompliance.

- The remedy or penalty for noncompliance should properly reflect the nature and extent of the violation.

- No single approach, such as calculation of the tax liability to the bondholders, if the bonds were declared taxable (Taxpayer Exposure) under the then existing guidelines, can provide a penalty that is appropriate for all violations.

The procedures for correcting a failure to pay rebate are long standing and are defined in Treas. Reg. Sections 1.148-3(h)(1), 1.148-3(h)(2) and 1.148-3(h)(3).

- Treas. Reg. Section 1.148-3(h)(1) provides that the failure to pay the correct rebate amount when required will cause the bonds of an issue to be arbitrage bonds (taxable) unless the Commissioner determines that the failure was not caused by willful neglect and the Issuer promptly pays a penalty. If the issue consists solely of governmental or qualified 501(c)(3) bonds, the penalty equals 50 percent of the rebate due, plus interest. Otherwise the penalty is equal to 100 percent of the rebate due, plus interest.

- Treas. Reg. Section 1.148-3(h)(2) provides that interest on the unpaid rebate amount accrues at the underpayment rate under IRC Section 6621 beginning on the date the correct rebate amount is due and ending on the date 10 days before it is paid.

- Treas. Reg. Section 1.148-3(h)(3) provides that the penalty is automatically waived if the rebate amount that the Issuer failed to pay is paid within 180 days after the discovery of the failure, unless the Commissioner determines that the failure was due to willful neglect, or the issue is under examination by the Commissioner at any time during the period beginning on the date the failure first occurred and ending 90 days after the receipt of the rebate amount.

In July 2005, Rev. Proc. 2005-40 was issued to provide procedures for correcting a failure to pay rebate, for establishing the lack of willful neglect and concerning requests for an extension of time to pay or a waiver of the penalty. Rev. Proc. 2005-40 set out eight factors to be used to determine if the failure to timely pay the correct rebate amount was due to willful neglect. It stated that the IRS would consider:

- The unpaid rebate amount;

- The sophistication of the Issuer;

- The length of the delay;
- The steps taken to comply, including the steps taken after the discovery of the failure to pay;
- The steps taken to prevent recurrence;
- The nature of the failure;
- Any history of timely or late payments by the Issuers; and
- Any other relevant information.

Rev. Proc. 2005-40, in Section 4.0, provided time limits for an IRS response and set out the options available to the Issuer.

- If the IRS does not notify the Issuer in writing within 90 days after receiving the explanation of the lack of willful neglect, the explanation is accepted and the penalty is waived.
- If, based on the explanation submitted by the Issuer, the IRS is unable to make a determination that the failure was not due to willful neglect, the IRS will notify the Issuer in writing within 90 days after receiving the explanation and describe any additional information needed, the IRS contact person, and provide the Issuer with a period of not less than 21 days to provide the information.
- If the IRS is still not able to make a determination, the Issuer is entitled, upon request, to a conference with the IRS.

The Treas. Reg. Sections under 1.148-3(h) and Rev. Proc. 2005-40 will be referred to jointly as Rebate Failure.

In June 2007, the TEB Subgroup compiled a report called “After the Bonds are Issued: Then What?”[116] a voluntary Issuer assessment of post issuance tax compliance. This report initiated the Post Issuance Compliance Policies and Procedures movement.

In June 2008, the TEB Subgroup produced a report entitled “The Streamlined Closing Agreement for Tax-Exempt Bonds: A Cure for Common Violations.”[117] That report grew

[116] https://www.irs.gov/pub/irs-prior/p4344--2007.pdf.
[117] https://www.irs.gov/pub/irs-prior/p4344--2008.pdf.

out of the perceived need for a simple, predictable, low-cost procedure for Issuers of tax-exempt bonds and conduit borrowers[118] of tax-exempt bond proceeds to voluntarily correct violations of federal tax law based on the TEB Subgroup's concern that the then current voluntary compliance program would be unable to accommodate the anticipated dramatic increase in voluntary assessments of post issuance tax noncompliance. At that time, the TEB Subgroup recommended that certain relatively common violations could be dealt with on a more streamlined basis, without the need for costly, time consuming, individualized negotiation. The possible covered violations included:

- Failure to timely invest a refunding escrow in State and Local Government Series securities (SLGS).
- Non-compliance with the "mixed escrow" rules of Treas. Reg. Section 1.148-9(c)(2).
- De minimis nonqualified use of bond-financed facilities.
- Change of election as to the applicable low-income test under IRC Section 142(d) for exempt facility private activity bonds for "qualified residential rental projects."
- Excess use of bond proceeds to pay issuance costs in violation of IRC Section 147(g).
- Use of bond proceeds for projects not included in original TEFRA notice.
- Violation of the 120 percent economic life limitation under IRC Section 147(b).
- Change in use of financed facilities without ability to take remedial action; for example, because of noncompliance with applicable time periods under the remedial action regulations.
- Change in use of financed facilities subjecting interest on the bonds to the alternative minimum tax (AMT) and not qualifying for Rev. Proc. 97-15.
- Failure to make a timely identification of a hedge under Treas. Reg. Section 1.148-4.

[118] A borrower of bond proceeds in a conduit financing.

In June 2010, the TEB Subgroup produced a report entitled “Improvements to the Voluntary Closing Agreement Program for Tax-Exempt, Tax Credit and Direct Pay Bonds”[119] (2010 Report). That report made specific recommendations with respect to the then current TEB VCAP, including proposed forms of closing agreements and the streamlined closing agreement program (SVCAP) for tax-exempt and tax-advantaged bonds. The 2010 Report recommended additions and changes to make VCAP and SVCAP more inclusive, more flexible and less costly to administer.

Effective April 1, 2017, the IRS implemented new audit procedures and best practices. Under these procedures, the IRS will send a letter to the Issuer indicating that an audit has commenced. The agent has the option to either include an Information Document Request (IDR) with the letter or call the Issuer to discuss the document requirements before sending the IDR. If the agent mails the IDR with the initial contact letter, the agent will discuss the IDR with the Issuer during an initial call and, if necessary, tailor the IDR and timeline.

Support for the Project

The TEB Subgroup took multiple steps to validate support for this project. The Subgroup solicited information from representatives of constituencies within the tax-advantaged bond community and the IRS. The goal was to confirm their views as to the worth of the project, to solicit ideas as to how an effective program might work, and to identify substantive problems which might be appropriately addressed under such a program. Christie J. Jacobs, Director of Indian Tribal Governments and Tax-Exempt Bonds, and Bob C. Griffo, Tax Law Specialist/Technical Advisor, were extremely supportive of this project and provided background information. The TEB Subgroup also discussed this project with several tax attorneys at Issuer bond counsel firms to assess the needs of the tax-advantaged bond community. Finally, the TEB Subgroup consulted

[119] https://www.irs.gov/pub/irs-prior/p4344--2010.pdf.

with the EP Subgroup of the ACT to discuss voluntary compliance programs which have been implemented with respect to qualified employee retirement plans.

The Project

The TEB Subgroup believes that additional revisions are needed to the TEB VCAP to:

- Contain defined rules to calculate standard Resolution Amounts agreeable to Issuers and the IRS while still allowing for negotiations in unusual fact situations;
- Use an approach based on when the violation is discovered and reported, and who discovers it;
- Incorporate the severity of the violation and the size of the Issuer;
- Ensure that the correction process is cost effective for the Issuers and efficient for the IRS;
- Encourage Issuer compliance and self-correction; and
- Provide finality for the Issuer without burdening IRS resources.

The current TEB VCAP process is defined in Section 7.2.3 of the IRM and Notice 2008-31. Therefore, this proposal falls within the scope of the TEB Subgroup and the IRS TEB Group's authority.

The Need for Change

In general, the current TEB VCAP procedures contain factors that discourage voluntary Issuer compliance. These include:

- The costs associated with making a submission.
- The payment amount to resolve the violation (Resolution Amount) is based on the present value of the bondholder's calculated tax liability if the bonds were declared taxable (referred to as Taxpayer Exposure of the bond issue). Unless specifically instructed otherwise or a more accurate measure of the particular bondholder's tax rate is available, the average investor's highest tax bracket is 29 percent.[120] This rate was first defined in Rev. Proc. 97-15 and is contained in the

[120] This rate should be lowered, following the enactment of Public Law No. 115-97, 131 Stat. 2054 (2017), also referred to as the Tax Cuts and Jobs Act.

Computation of Taxpayer Exposure section (4.81.6.5.3.1) of the IRM. For purposes of determining Taxpayer Exposure, bonds that have been called for redemption and defeased by a defeasance escrow are considered outstanding until their actual date of redemption.

- The Resolution Amount paid by the Issuer is equal to 100 percent of the Taxpayer Exposure if the settlement is requested within six months of the violation and increases to 110 percent if the submission is more than six months and less than one year after the violation. The IRM does not have prescribed Resolution Amounts if the settlement occurs after one year. At that point, the amount becomes subject to negotiation.

- The settlement amounts are negotiated in a labor-intensive process involving the Issuer's tax counsel and IRS resources.

The Suggestion

The TEB Subgroup suggests a general approach for increasing voluntary compliance following the Rebate Failure previously discussed. The approach consists of:

- Resolution Amounts are readily determinable.

- The window to avoid an additional penalty is based on discovery rather than the occurrence of the violation.

- The Resolution Amount and any underpayment interest accrues from the date of the violation.

- An additional penalty amount is required if the correction is not made within a defined period after Issuer discovery.

- The IRS has a defined time limit to review and approve the Issuer explanation and settlement rather than beginning negotiations.

- If the violation is discovered by the IRS while the issue is under audit, the Issuer is responsible for the maximum Resolution Amount.

The key to implementing the suggested approach for the remedial actions listed in IRM Section 7.2.3 is to define a readily determinable Resolution Amount. While it is beyond the scope of this document to determine the parameters of the formula for calculating an acceptable Resolution Amount and the amount of any potential penalty, the TEB Subgroup's suggested approach is to have a Resolution Amount that is not subject to negotiation except in unusual situations, so that Issuers will have a defined amount on

which to base their correction approach. The TEB Subgroup also suggests that a threshold be established to eliminate the filing requirement for de minimis violations. The establishment of criteria for de minimis violations is also beyond the scope of this report.

Issuers and the IRS benefit from a Rebate Failure approach for self-monitoring and self-correction:

- Issuers can make approved corrections with minimal costs.
- The IRS would not have to devote substantial resources to the program.
- It would encourage self-policing and self-correction for the majority of the Issuer population without the IRS's direct involvement.
- The IRS would be able to devote more of its scarce resources to unusual situations and a data driven audit process to efficiently administer compliance violations.

The fear of an examination of a particular obligation (and the resulting potential liability and penalties) may not be enough to ensure Issuer post issuance compliance. The IRS should encourage self-policing by Issuers to self-correct and self-report violations. To entice Issuers to implement compliance programs and self-report violations, the current TEB VCAP needs to be revised to provide sufficient incentives to encourage Issuers to participate. The correction options must be simple, cost effective and encourage self-compliance by providing an economic incentive for Issuers to actively monitor and self-correct violations.

Why Now?

For 2018, the IRS has announced that it will rely on a new data driven approach for examining tax-advantaged obligations. The TEB Subgroup and the individuals with whom this approach was discussed believe that the suggested changes contained in this report together with the revised audit approach that was implemented in April 2017 would allow the IRS to focus scarce resources on Issuers with the most potential for noncompliance. In developing an effective examination and correction program, the IRS faces several challenges:

- *Resources are Shrinking and the Workload is Increasing* – TEB Field Operations, which is responsible for bond examinations, is expected to have only 19 agents conducting examinations by June 2018, down from 23 at the Oct. 1 start of the fiscal year. For comparison, in 2009 the TEB Field Operations had 60 agents, six managers, five support staff, and a technical adviser. On the enforcement side, the IRS expects to close 577 examinations in the TEB Field Operations in fiscal 2018, which began on Oct. 1, 2017 and ends on Sept. 30, 2018. That is significantly down from the 717 closed examinations in fiscal 2017, but slightly higher than the 570 concluded in fiscal 2016 and the 569 in fiscal 2015.[121] The reduction in resources and reduced number of examinations may lead some Issuers to conclude that the probability of examination is so low that instituting a compliance program or participating in the TEB VCAP is not worthwhile.

- *Volume of smaller issues remains high* – Tax-exempt bond issues under $10 million comprise most of the tax-exempt bond issues in recent years. As reported by the IRS Statistics of Income Division,[122] for reporting years 2006 – 2015 (information most readily available as of the date of this report), the number of issues of tax-exempt bonds with par values under $10 million constituted approximately 80 percent (122,296 out of 153,686) of the total number of all issues of tax-exempt bonds issued during the 10-year period. The par amount of all tax-exempt bonds with par values under $10 million comprised approximately 11 percent ($220 billion out of $1,978 billion issued) during that same 10-year time period. The large number of small issues may also lead some Issuers to conclude that the probability of examination is so low that instituting a compliance program or participating in the TEB VCAP is not worthwhile.

- *Reduction in Tax Rates* – As a result of the Tax Cuts and Jobs Act reduction in corporate and many individual tax rates, the Computation of Taxpayer Exposure tax rate should be reduced. The TEB Subgroup believes that the 29 percent Taxpayer Exposure rate should be revised as a result of the changes in the tax rates for exposure amounts that include the 2018 tax year and thereafter. Reduction of the potential Taxpayer Exposure could also reduce the incentive for Issuers to institute compliance programs and participate in the TEB VCAP. The TEB VCAP AMT adjustment under IRM 4.81.6.5.3.4 should also reflect the elimination of the corporate AMT by the Tax Cuts and Jobs Act for tax years beginning after 2017.

Based on these factors, the risk of an examination of a particular issue (and the resulting potential liability) may not be sufficient to ensure post issuance compliance. The IRS should encourage self-policing by Issuers to self-correct and self-report

[121] The Bond Buyer published December 28, 2017 – 2018 Outlook: IRS implementing data driven muni bond audits.
[122] https://www.irs.gov/statistics/soi-tax-stats-tax-exempt-bond-statistics.

violations. To entice Issuers, particularly small Issuers with few resources, to implement compliance programs and self-report violations, the TEB VCAP should be revised to provide sufficient incentives to encourage Issuers to participate. The correction options must be simple, cost effective and encourage self-compliance by providing an economic incentive for Issuers to actively monitor and self-correct violations.

How Do You Get Issuers to Comply?

After digesting the due diligence, the TEB Subgroup determined that the best means to promote compliance would be to modify the TEB VCAP to further streamline the process and eliminate the need for costly, time consuming, individualized negotiations on the part of the IRS, the Issuer and the Issuer's tax counsel. The violations covered by a revised TEB VCAP and the parameters for resolving covered violations should be evaluated based on multiple criteria to determine an appropriate Resolution Amount which incentivizes Issuers to implement a compliance program and self-report and self-correct violations.

The most effective way to encourage Issuers to comply is to make it more advantageous for them to correct violations on a timely basis. That involves:

- The ability to know in advance the Resolution Amount and underpayment interest amount arising from noncompliance, in other words, certainty as to treatment.
- Having defined grace periods.
- Having a penalty that is appropriate to the nature of the violation.
- Having a fair and impartial procedure to resolve disputes

These recommendations support the IRS objectives for the TEB VCAP as outlined in IRM 7.2.3.1.1. According to the IRM, TEB VCAP's primary objectives are to:

- Encourage Issuers to exercise due diligence in complying with federal tax requirements for tax-advantaged bonds.
- Ensure others that use tax-advantaged bond proceeds exercise due diligence in complying with federal tax requirements.
- Encourage Issuers to voluntarily report discovered violations to the IRS.

- Provide a way to correct these violations expeditiously.

The TEB Subgroup suggests that the IRS consider an expansion of the Self-Correction portion of the IRM hierarchy beyond the current remedial actions. Such an expansion would provide closure to the Issuer without significant IRS involvement based on a standard such as the lack of willful neglect as defined in Rev. Proc. 2005-40 and a predefined mutually agreeable Resolution Amount.

III. RECOMMENDATIONS

The TEB Subgroup recommends that the existing correction structure be modified to include an option, similar to the Rebate Failure and reserve the TEB VCAP for unusual fact situations. This would group the violations into three categories:

- Self-Correcting
    - Remedial Action
    - Standard Resolution (new)
- Self-Reporting
    - Streamlined Voluntary Closing Agreement Program
    - Voluntary Closing Agreement Program
- Discovery Under Audit

This structure is similar to the programs used in the EP area and are designed to encourage compliance, reward voluntary compliance and avoid the costly participation in a full examination and potential discovery of other noncompliance issues leading to a large liability arising out of the examination process.

Self-Correcting – Remedial Actions are currently prescribed by regulations or revenue procedures. The addition of a Standard Resolution would be the Rebate Failure equivalent for non-rebate liability violations. If the Issuer agreed to pay a predefined Resolution Amount, with an explanation of lack of willful neglect, within a predefined time period, the IRS would have a defined time to accept or reject the explanation. If accepted by the IRS, the violation would be deemed to be corrected. If rejected, the IRS

would request additional information from the Issuer and work with the Issuer on a mutually agreeable resolution.

Self-Reporting – This approach, similar to the current TEB VCAP would be used when the fact pattern is unique and the Issuer cannot use the remedial action provisions or does not agree with the results of the Standard Resolution.

The Resolution Amount for correcting a violation would be based on the violation, the timing of its discovery, and the ability to show a good faith effort to remedy the violation in a timely manner after the violation is identified, similar to the Rebate Failure provisions. Self-Reporting would require Issuers to file their proposed correction before being notified by the IRS of an audit.

The Issuer Resolution Amount would consist of three components:

- Economic Benefit
- Late Interest
- Penalty

Economic Benefit – IRM 4.81.6.5 sets forth the basis for entering into closing agreements which include the Taxpayer Exposure, the amount of income tax liability of a conduit borrower and the arbitrage benefit received. The TEB Subgroup believes that the Resolution Amount should focus on a defined formula-driven amount that is acceptable to both the Issuer and the IRS, subject to negotiations based on unusual or extreme fact situations. The TEB Subgroup also suggests that the time period for determining the Resolution Amount would start at the time the violation commenced and end when the violation is corrected.

Interest – Represents the time value of the Economic Benefit. This would be calculated based on the IRC Section 6621 underpayment rates from the time the violation commenced and end when the violation is corrected or on a date 10 days before the Resolution Amount is paid, to be consistent with Treas. Reg. Section 1.148-3(h)(2).

Penalty – Any additional penalty should reflect the timing of the discovery of the violation, whether the violation was self-reported and the good faith effort by the Issuer to remedy the violation. The TEB Subgroup suggests a grace period of 180 days from discovery of the violation during which the Issuer could request a waiver of the penalty if the Issuer can show that the violation was not due to willful neglect. The TEB Subgroup suggests that if the violation is reported outside of the prescribed time limits, minimal penalties for self-reporting would be implemented to reward reporting outside the time limits. These non-audit self-reporting penalties should reflect the length of time from discovery of the violation and whether an Issuer is a small issuer. The exact penalty amounts are beyond the scope of this recommendation; however, it should be noted that those amounts should be minimal to incentivize self-reporting and self-correction (for example, $1,000 for every six-month delay).

De Minimis Violations – The TEB Subgroup recommends that a standard be developed for what constitutes a de minimis violation that would be an exception to the need for reporting. The IRS has used such an approach in other areas relating to tax-advantaged obligations, including in the regulations which establish the “spending exceptions” for arbitrage rebate under IRC Section 148 and Treas. Reg. Section 148-7(b)(4). Under these rules, the final benchmark for the 18- or 24-month spending exception is not violated if the unspent proceeds amount is less than $250,000 or three percent of the issue price. The TEB Subgroup suggests that the IRS consider a de minimis Resolution Amount or a tax-advantaged obligation par amount that would exempt the Issuer from the formal correction process.

The Resolution Amount would be based on the sum of the Economic Benefit, Interest and Penalty that reflected who discovered the violation and when the violation was reported. Issuer Self-Correcting violators would pay the lowest percentage of the Economic Benefit and would not be subject to a Penalty if the discovery was reported within the prescribed grace period. Issuer Self-Reporting would require the payment of a higher percentage of the Economic Benefit, but not 100 percent, and would not be subject to a Penalty if the discovery was reported within the prescribed grace period.

Discovery on audit would require the payment of the full Economic Benefit and Penalty as a result of being discovered by the IRS.

Benefits to the IRS

The benefits to the IRS of the proposed changes in the TEB VCAP are:

- The implementation of a Standard Resolution that would limit the negotiation process and allow the IRS to review an Issuer's explanation and approve or decline the request more efficiently.
- By creating a category of De Minimis Violations, the IRS would eliminate the effort associated with small settlements and encourage self-correction for less significant failures.
- The creation of the Standard Resolution and exception for De Minimis Violations would allow the IRS to devote its resources to more significant violations.
- The implementation of this approach would increase Issuer compliance and self-correction, reduce the population of violators and allow the IRS to focus its resources on the data driven audit approach and target a smaller population of perceived violators.

The reduction of the population of potential violators would allow the IRS to stimulate post issuance compliance by more effectively using resources and sending a message to Issuers that it is more cost effective to be in compliance.

Benefits to Issuers and Conduit Borrowers

The benefits to the Issuers are:

- The responsibility for compliance is linked directly with the benefits of compliance.
- Issuers will be able to better ascertain in advance the cost of non-compliance.
- The cost/penalty is reasonably based on the nature, extent and severity of the violation.
- It removes the adversarial nature of existing procedures.
- Issuers will have more certainty regarding their potential liability.

- If a payment needs to be made, the Issuer will be able to quantify and justify the savings realized by being proactive and will have an incentive to self-report.

The addition of the Standard Resolution and changes to the TEB VCAP will encourage Issuers to self-monitor and be in compliance with their post issuance compliance because of the reduction in the level of time and effort to correct violations.

Implementation

The TEB Subgroup recognizes that the revision to the existing program requires an appropriate procedural vehicle to accomplish the revisions. The choice to use a revenue procedure, a notice, IRM amendments or some combination of these approaches is beyond the scope of this recommendation. However, the TEB Subgroup has consciously limited its suggestions to those areas that would not appear to require statutory revisions and are within the scope of the TEB Group's authority.

The key to implementing the Standard Resolution and creating a De Minimis Violation exception is to limit negotiations inherent in the current process and reduce the regulatory and administrative burdens imposed on Issuers and the IRS.