



EXEMPT ORGANIZATIONS

LETTER FROM THE DIRECTOR

Dear Colleagues:

Exempt Organizations (EO) respects the nonprofit sector’s work and supports its efforts by helping to ensure that the public maintains trust in the exempt sector. Over this past year, our leadership and staff have continued to support these efforts through a robust educational program, a more efficient determination process, and a comprehensive compliance program. We also have continued to communicate the importance of organizational governance and its expected impact on compliance with the tax law.

As we move forward into a new year, we view Fiscal Year 2011 as an opportunity to build on our recent efforts, fine-tune certain projects and programs, and prepare for the inevitable changes in the landscape of exempt organizations. Our work for this year comes together around three major themes:

- **EO Integrates.** In recent years, EO initiated several projects focusing on specific segments of the sector, as well as particular compliance issues affecting a cross-section of exempt organizations. We believe it is now appropriate to incorporate these projects and lessons learned into the overall EO processes, rather than keeping these efforts as separate projects.
- **EO Supports and Collaborates.** In the coming year, IRS leadership will focus agency-wide attention on certain critical issues, including international activities and compliance with the passage of recent legislation. These important efforts require significant resources from EO. Other key projects will involve collaborative work with the National Research Program and non-filer initiatives.
- **EO Invests.** In order to keep up with the ever-changing exempt organization sector, EO will invest time and resources in a wide array of initiatives, which will touch a broader audience.

This report provides updated statistics and discussions of our accomplishments in FY 2010, as well as a preview of our programs in FY 2011. We look forward to working with the exempt community and our stakeholders and continuing to share what we learn.

Respectfully yours,

Lois G. Lerner

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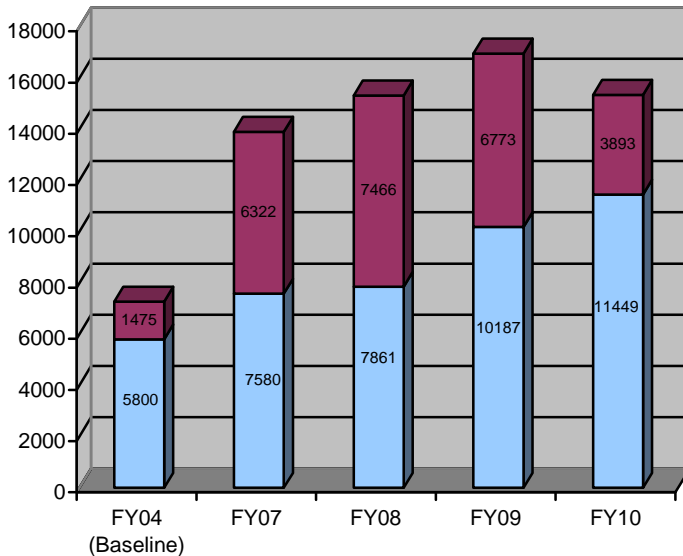
Lois G. Lerner
Director, Exempt Organizations

Compliance

This graph displays the combined total number of returns examined through the traditional examination process and the less resource-intensive compliance checks.

Compliance checks inquire about an item on a return or solicit information about an organization's operations, enabling us to touch more organizations than we could by using an exclusively exam-based strategy.

Total number of returns examined



■ Traditional Examinations ■ Compliance Checks

EO Examinations

EO Examinations is responsible for enforcement activities, including both compliance checks and audits of exempt organizations. EO Examinations is made up of field exam groups; the Exempt Organization Compliance Unit (EOCU), which conducts compliance checks; Review of Operations (ROO), which does follow-up reviews of organizations; and Compliance Strategies Critical Initiative (CSCI), which coordinates EO's strategic planning, monitors progress of critical initiatives, and analyzes the results of these projects.



Nan Downing
Director, EO Examinations

EO's traditional examinations, coupled with less resource-intensive compliance checks, continue to deliver impressive compliance results.* By expanding our collaboration with outside agencies — including the Social Security Administration and the states — we obtained valuable electronic data that allowed us to more readily identify potential nonfilers and to focus our exam resources on noncompliant organizations. Our methods of case selection for examinations resulted in a higher percentage of cases selected involving significant issues and agents securing a considerably higher number of delinquent returns than in any recent year.

**2010 legislation provisions necessitated a higher ratio of traditional exams to compliance checks than in the past, resulting in fewer overall closures.*

Applications for Tax Exemption

Rulings and Agreements

EO Rulings and Agreements (R&A), made up of Determinations and Technical, is responsible for reviewing applications for exemption, issuing private letter rulings, providing technical advice, and collaborating with Chief Counsel's office and the Department of the Treasury to deliver formal guidance.



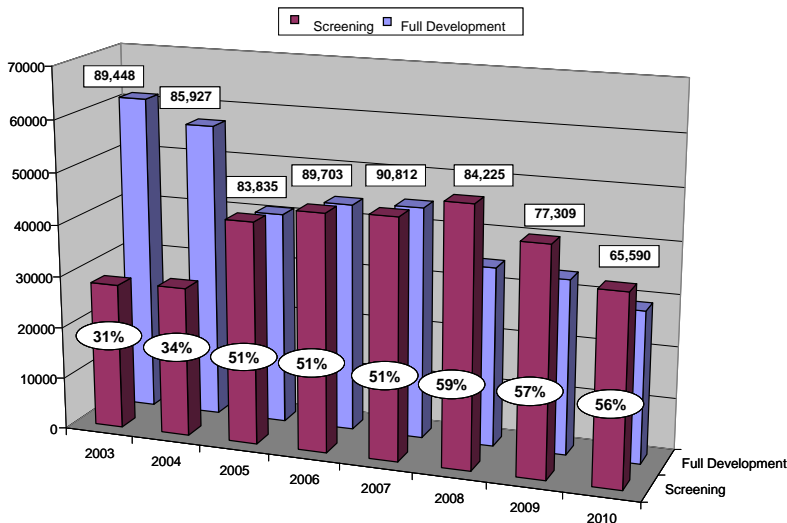
Rob Choi, Director
EO Rulings & Agreements

In 2008, the revision of the Form 990 eliminated the need for the advance ruling process for section 501(c)(3) organizations. Under the former process, an applicant organization was granted public charity status conditionally for its first five years, after which it had to come back and demonstrate it had sufficient public support to be classified as a public charity rather than a private foundation.

Under the new process, in lieu of coming back in five years, an organization shows that it has met and continues to meet the public support test on either Schedule A (Public Charity Status and Public Support) of Form 990 or Form 990-EZ.

The new process eliminated about 20,000 follow-up cases from the workload, which traditionally were disposed of through the screening process. While the number of cases went down, those remaining were more complex.

EO Determinations Closures 2003-2010



This chart compares the number of cases closed through the screening process and cases closed after in-depth development in FY 2003-2010.

Despite a more difficult caseload, experience gained and efficiencies initiated to the screening program over the last several years have enabled us to continue to maintain a high level of screening.

Education & Formal Guidance

With the expanded responsibilities imposed by new legislation and a growing customer base, EO continued its extensive education and communication efforts in FY 2010.

- Provided an online toolkit to internal and external stakeholders to alert the tax-exempt community of the filing relief program available to small organizations at risk for losing their tax exemption for failure to file
- Prepared and distributed information about new legislation, including the American Recovery and Reinvestment Act and Affordable Care Act, to the tax-exempt community
- Hosted the inaugural joint workshops with Seton Hall University, West Virginia University and Lawrence Technological University to kick off the work of the Academic Institution Initiative
- Hosted 18 Small & Midsize 501(c)(3) Workshops nationwide, which offered guidance on a variety of topics such as EO filing requirements, unrelated business income, and public inspection and disclosure requirements
- Released an updated gaming publication, *Tax-Exempt Organizations and Gaming*, which helps organizations understand how their activities impact their tax-exempt status by describing the unique reporting and filing responsibilities of each type of exempt organization

Customer Education and Outreach

Customer Education and Outreach (CE&O) offers specialized education and outreach programs to help exempt organizations understand their tax responsibilities. CE&O oversees the Charities and Nonprofits pages of IRS.gov, develops publications and web-based materials, manages the Academic Institution Initiative, and offers face-to-face workshops and seminars on EO tax laws. In addition to CE&O core staff, subject-area experts from Examinations and R&A support EO outreach efforts and augment CE&O's mission.



Bobby Zarin, Director
EO Customer Education & Outreach

The table below shows FY 2010 outreach efforts, as well as the changes from FY 2009.

EO Education and Outreach Efforts

Outreach Efforts	FY 2008 Total (Baseline)	FY 2009 Total	FY 2010 Total*	Change from FY 2009
EO Update subscribers	75,473	101,730	130,176	28%
Speeches, Tax Forums and Workshops*	289	305	194	-36%
IRS.gov/eoH website views	4,960,256	4,994,022	5,333,380	7%

*The number of outreach events, most of which are generated externally, reached an all-time high in FY2008/2009, due to presentations describing the redesigned Form 990, a major EO initiative.

Education & Formal Guidance (cont.)

EO makes technical interpretations of the laws and procedures publicly available through regulations, revenue rulings, revenue procedures, announcements, and notices.

In FY 2010, published guidance highlights included:

One-Time Filing Relief for Small Organizations

May 17, 2010, was the first filing deadline to trigger revocation under the Pension Protection Act (PPA) for organizations that failed to file for three consecutive years.

On July 26, 2010, IRS Commissioner Doug Schulman announced a one-time, two-part filing relief program to provide an additional opportunity for small organizations at risk for revocation to file.

The IRS posted a list of names and last-known addresses of possible at-risk organizations on the IRS.gov website and provided guidance on coming back into compliance. This guidance included details about completing filing requirements, along with frequently asked questions.

The guidance extended that the deadline to file to October 15, 2010, for the smallest organizations. Those with gross receipts of \$25,000 or less could retain exemption by filing the simple Form 990-N, the e-Postcard, by the October 15 date.

Organizations eligible to file the Form 990-EZ for the past three years could save their tax-exempt status by filing their three delinquent returns and pay a small compliance fee by October 15, 2010.

Notice 2010-39

The Affordable Care Act (ACA) imposed four additional requirements for hospitals to qualify as section 501(c)(3) organizations. Notice 2010-39 explained the new requirements and additional reporting and excise taxes enacted in the ACA, and requested comments from the public on how the IRS should provide guidance on the new provisions.

Regulation 4965 - Prohibited Tax Shelter Transactions

Section 4965 imposes an excise tax on tax-exempt organizations and associated employees who engage in prohibited tax shelter transactions. These regulations explain the tax and the associated disclosure rules. The regulations finalized temporary regulations issued in 2007.

Announcement 2010-19

The announcement explains procedures that a trust may use to request a ruling that it was-- and continues to be-- a Type III supporting organization. It further describes how to request a refund for private foundation excise taxes paid in 2008.

This announcement also describes the procedure under which a private foundation can terminate its private foundation status by operating as a public charity for 60 months.

Organizational Information

EO Staffing

The EO Rulings and Agreements office (R&A) processes applications for tax exemption and provides direction through private letter rulings and technical guidance.

The EO Examinations office (Exam) promotes compliance by analyzing operational and financial activities of exempt organizations. These activities include developing processes to identify areas of noncompliance, developing corrective strategies and assisting other EO functions in implementing these strategies.

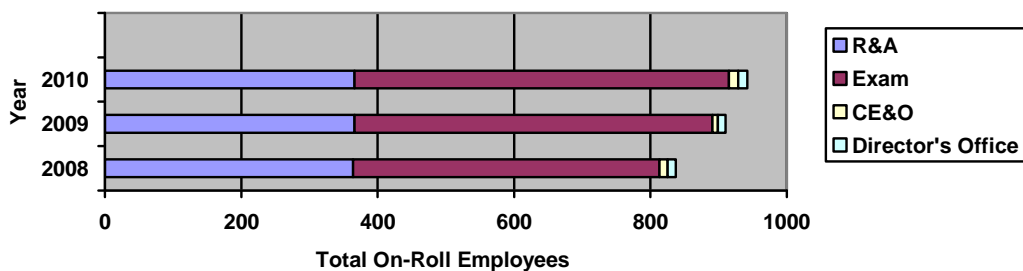
The EO Customer Education and Outreach office (CE&O) coordinates, assists and supports the development of internal and external communications, forms and publications and external education and outreach efforts.

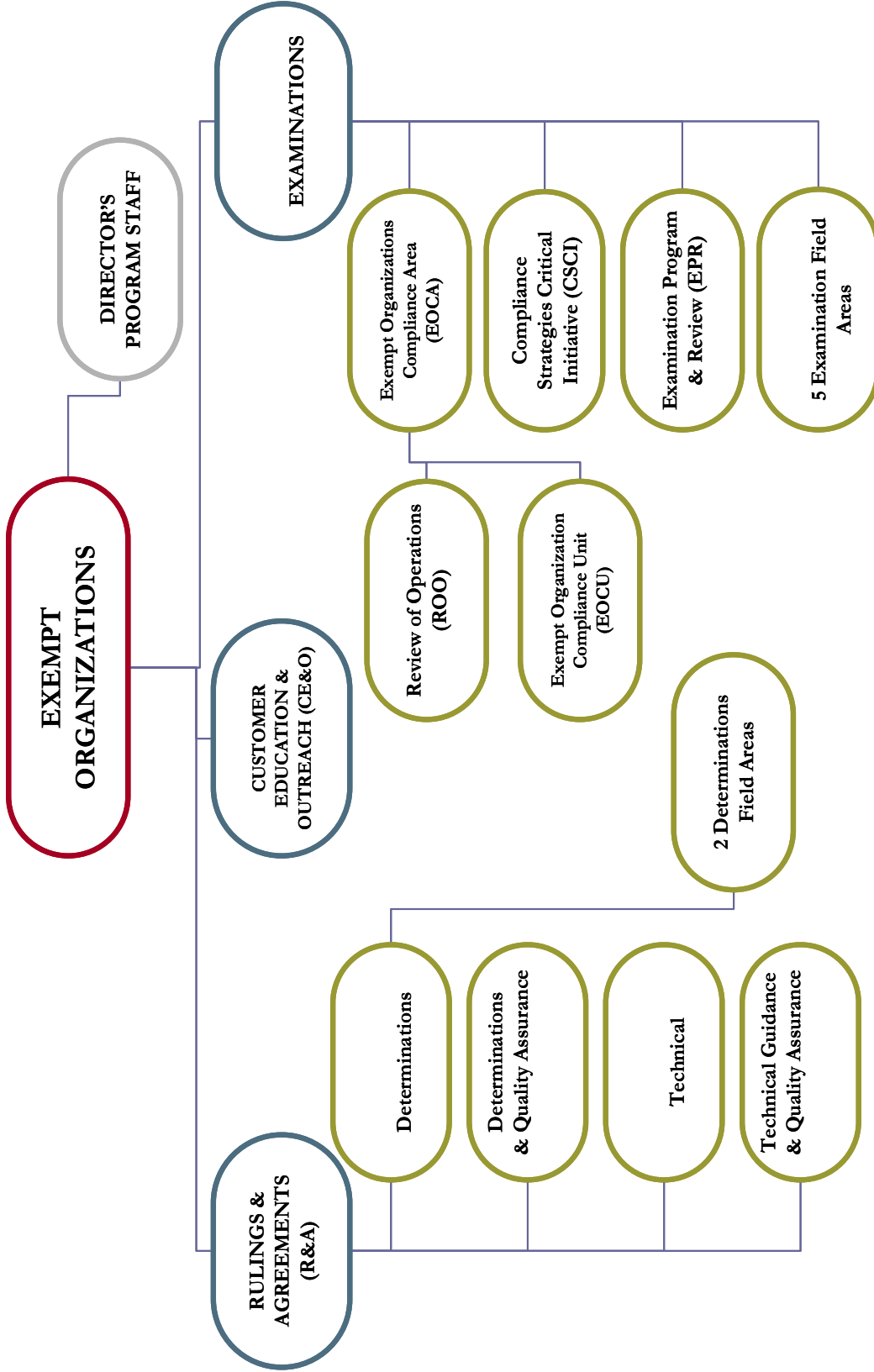
EO continues to grow in order to meet the needs of the tax-exempt community.

Table of EO On-Roll Employees over a 3-Year Period

	Rulings & Agreements	Examinations	Customer Education & Outreach	Director's Office	Total
2008	364	449	12	12	837
2009	366	525	8	11	910
2010	366	549	14	13	942

EO On-Roll Employee Growth over a 3-Year Period





Spotlight: Filing Relief Program

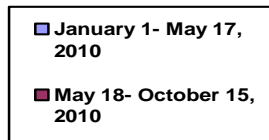
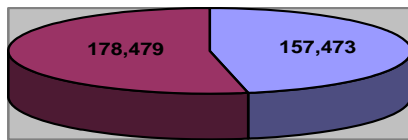
Background: The Pension Protection Act of 2006 made two important changes affecting tax-exempt organizations, effective the beginning of 2007. First, it requires all tax-exempt organizations, other than churches and church-related organizations, must file an annual return with the IRS. That includes small tax-exempt organizations with gross receipts of \$25,000 or less and had not previously had a filing requirement. They now are required to submit a Form 990-N, also known as an e-Postcard. Second, it mandates that any tax-exempt organization that fails to file for three consecutive years automatically loses its federal tax-exempt status.

Current Efforts: The **first three-year filing deadline** that could trigger revocation for failure to file was May 17, 2010. Despite an extensive outreach effort for the past three years, once the filing date arrived, the IRS realized that many organizations continued to be unaware of the tax law changes. On May 18, Commissioner Shulman announced that the IRS would provide additional guidance to help these small organizations maintain their tax-exempt status—even if they had missed the filing deadline. The Commissioner encouraged them to continue filing and reassured them that the IRS would do what it could to help them avoid losing their tax-exempt status.

On July 26, 2010, the IRS announced a **one-time two-part relief program** to bring these small nonprofit organizations back into compliance. First, the program extended the filing deadline to October 15 for the smallest organizations, those eligible to file the Form 990-N, the e-Postcard. Second, it provided for a voluntary compliance program for those eligible to file the Form 990-EZ for the past three years. Under this program, an organization had to file its three delinquent returns and pay a small fee by October 15. Form 990 and 990-PF filers were not eligible to participate in this program.

The IRS posted a **list of the names and last-known addresses of more than 300,000 at risk organizations** with filing due dates from May 17 through October 15, 2010, and no record of having filed a required annual return or notice for 2007, 2008 or 2009.

Immediately following the Commissioner's announcement, the IRS expanded its **outreach efforts** to alert the tax-exempt sector of the relief program. As a result, during the Filing Relief Program (between May 18 and October 15), more organizations filed 990-Ns than during the previous five-month period.



**These figures only reflect the number of 990-Ns filed, not the number of organizations that have filed or the number that originally were not filed timely and took advantage of the filing relief program. In addition, 4,621 organizations filed the 990-EZ form during the at-risk period.*

Total: 335,952 990-Ns filed by October 15, 2010

Post-October 15: Eligible organizations that properly filed according to the Filing Relief Program will remain tax exempt.

Revocation: By operation of law, organizations that failed to file annual information returns for three consecutive years, and organizations eligible to participate in the filing relief program that failed to do so by the October 15 deadline, automatically will be revoked as of the original due date of their third return. In early 2011, the IRS will notify these organizations, and will publish their names by posting a list of revoked organizations on IRS.gov.

Each month, as subsequent filing due dates pass, the IRS will expand the list to include the names of additional organizations that are revoked for failure to file for three consecutive years.

Contributions and tax deductions: Donors who contribute to organizations otherwise eligible to receive tax-deductible contributions can continue to take a tax deduction until the IRS publishes the name of the organization on the list of revoked organizations. A contribution to an organization listed on the IRS site as having lost its tax-exempt status is not tax deductible.

Reinstatement: An organization that wishes to retain its tax-exempt status must apply to have its tax-exempt status reinstated, even if it was not originally required to file an application for exemption. To do so, it must:

- File either Form 1023 or 1024, as appropriate;
- Pay the appropriate user fee; and
- Write automatically revoked on the top of the application and envelope.

EO Determinations will review the applications received in the normal course of business.

On-going Education: EO will continue its aggressive educational program to alert tax-exempt organizations of their annual filing requirements and the consequences of not filing.

Compliance Review: EO will conduct a compliance review of organizations that filed a Form 990-N but previously reported financial activity indicated they were ineligible to do so.

Spotlight: Redesigned 2008 Form 990 Filings

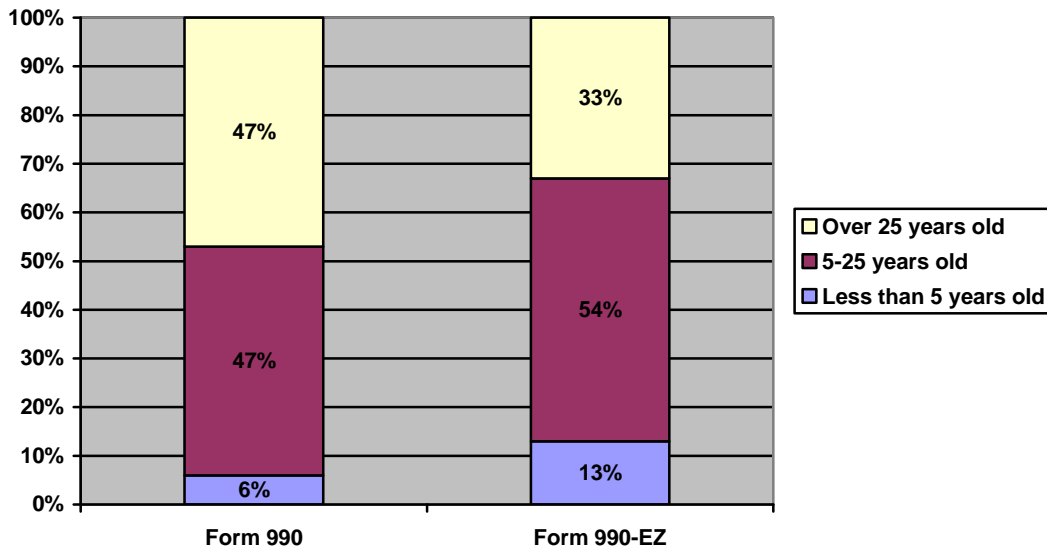
Statistics and Demographics for Redesigned 2008 Form 990 Filings

The IRS significantly redesigned Form 990, *Return of Organization Exempt From Income Tax*, for tax year 2008. Now that the filing season for tax year 2008 is nearly complete, the IRS has compiled the following demographic and statistical information on 2008 Form 990 (along with certain statistics on Forms 990-EZ and 990-N) filings and filing organizations, based on data available through September 30, 2010:

Demographics of Filing Population

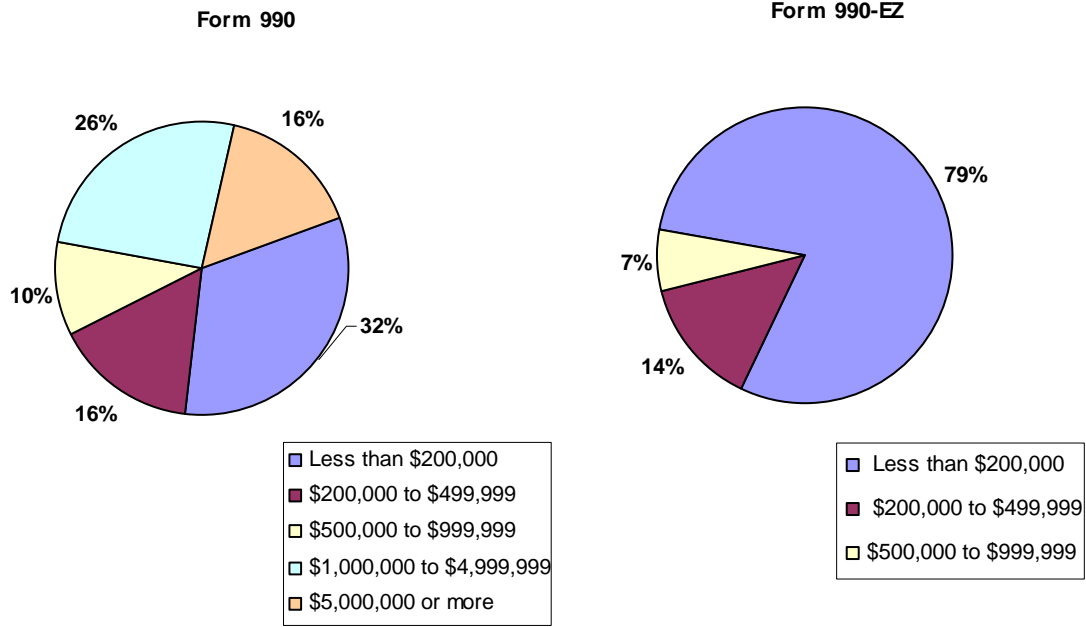
AGE OF ORGANIZATIONS

Age of Tax-Exempt Organizations Filing 2008 Form 990-Series Returns*

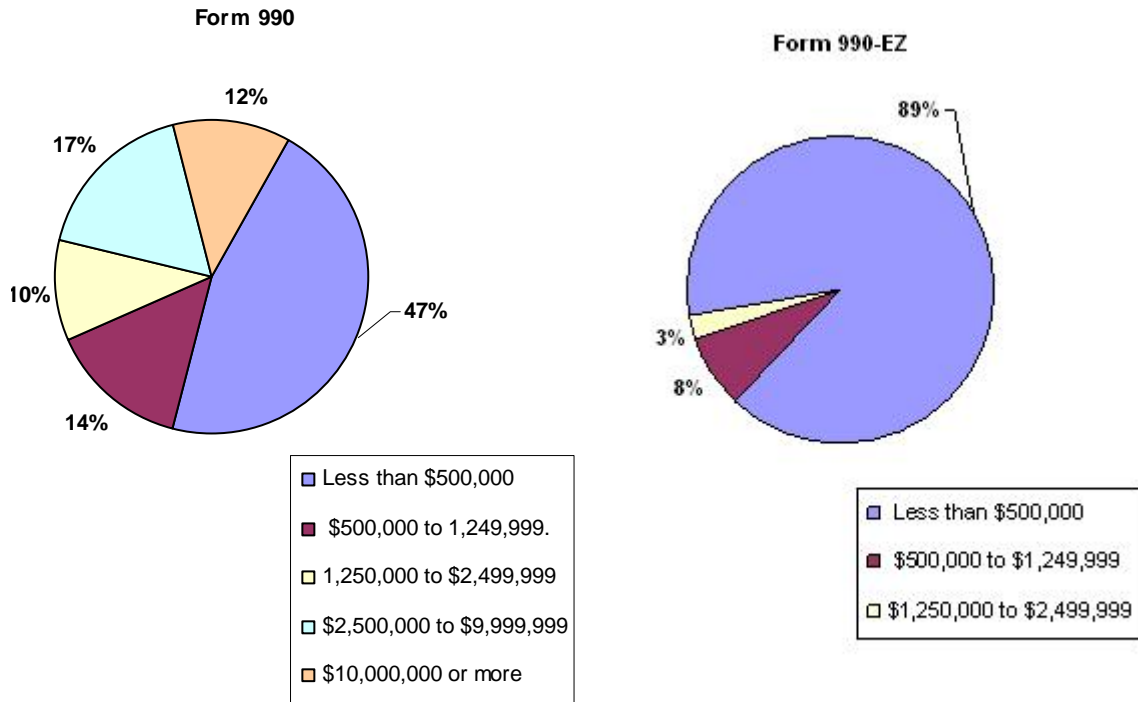


* Age reflects the date on which the organization's federal Employer Identification Number (EIN) was assigned. This does not necessarily reflect the date on which the organization was formally organized, received recognition of exemption by the IRS or filed its first return with the IRS.

SIZE OF ORGANIZATION by Gross Annual Receipts, as Reported by 2008 Filers of:



SIZE OF ORGANIZATION by End of Year Total Assets, as Reported by 2008 Filers of:



GEOGRAPHY OF ORGANIZATIONS by U.S. Regions, Tax Year 2008:

Geography by U.S. Regions*		
	Form 990	Form 990-EZ
	%	%
Northeast	18%	19%
Mid Atlantic	22%	22%
Gulf Coast	21%	19%
Great Lakes	18%	16%
Pacific Coast	21%	24%
Total	100%	100%

* For more information on identification of U.S. states in the geographical regions, go to: <http://www.irs.gov/charities/article/0,,id=137767,00.html>

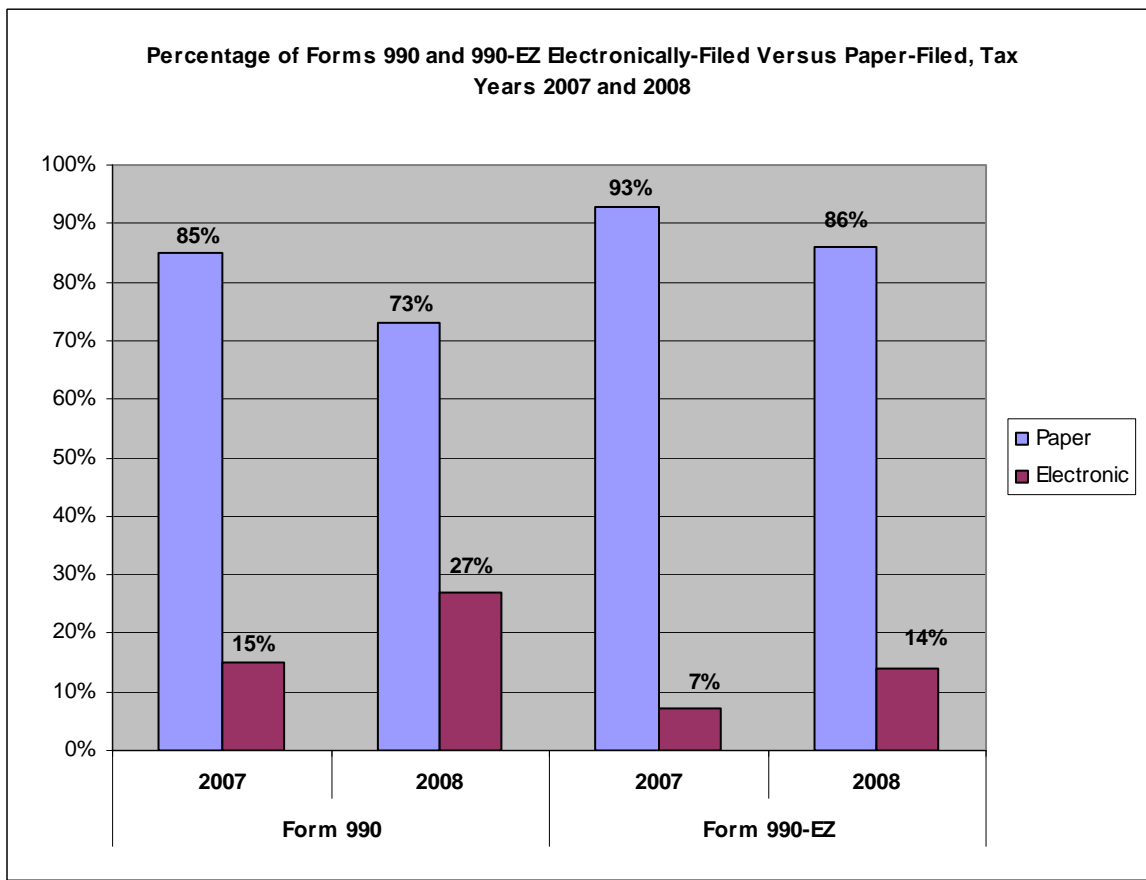
2008 Forms 990 and 990-EZ Statistics

Paper v. Electronic Filing*

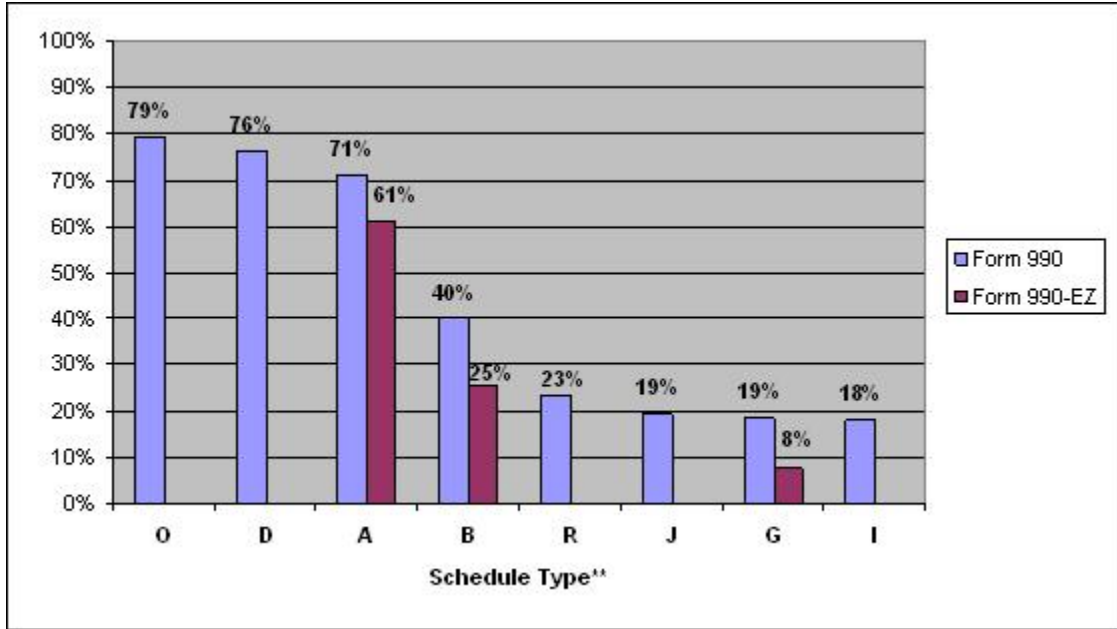
	Form 990		Form 990-EZ		Form 990-N (electronically filed)	
	2007	2008	2007	2008	2007	2008
Paper Returns	327,579	160,362	147,960	266,008		
Electronic Returns	59,664	57,975	11,864	44,362	242,614	292,002

Note: 52% of the organizations that filed the Form 990 for tax year 2008 could have filed the Form 990-EZ, based on assets and gross receipts thresholds for filing Form 990-EZ.

*Number of returns posted to IRS Business Master File as of September 30, 2010



Most Commonly Filed Form 990 and 990-EZ Schedules for Tax Year 2008*



Note: To date, approximately 90 percent of 2009 Form 990 filers have filed Schedule O, as compared to 79.4 percent for tax year 2008. All Form 990 filers are required to file Schedule O.

* Number of returns posted to IRS Business Master File as of September 30, 2010

** This chart includes the most commonly filed of the 16 Form 990 schedules:

Schedule A: *Public Charity Status and Public Support*

Schedule B: *Schedule of Contributors*

Schedule D: *Supplemental Financial Statements*

Schedule G: *Supplemental Information Regarding Fundraising or Gaming Activities*

Schedule I: *Grants and Other Assistance to Organizations, Governments, and Individuals in the United States*

Schedule J: *Compensation Information*

Schedule O: *Supplemental Information to Form 990*

Schedule R: *Related Organizations*

Schedules D, I, J, R, and O apply only to Form 990 filers.

Preparer Statistics

Paid-Prepared v. Self-Prepared				
	Form 990		Form 990-EZ	
	2007	2008	2007	2008
Paid-Prepared	81%	87%	50%	68%
Self-Prepared	19%	13%	50%	32%

Internet resources available to help with preparation of Form 990

To help filers complete the Forms 990, 990-EZ and 990-N, the IRS offers the following free, web-based resources available on www.irs.gov/charities and www.stayexempt.org:

- [Interactive virtual workshops and mini-courses](#) on multiple topics, including Form 990
- Compiled [FAQs](#) listing annual reporting requirements for tax-exempt organizations
- [Case Study videos](#) featuring a hypothetical tax-exempt organization and step-by-step instructions for completing that organization's Form 990
- [The NEW Form 990: What Tax-Exempt Organizations Need to know:](#) publication and related checklist
- [EO Update](#), a periodic newsletter with information of interest to tax-exempt organizations and tax practitioners who represent them, including Form 990-related updates

The IRS encourages comments and suggestions on how to improve the Form 990, schedules, and/or instructions. Please send to:

Form990Revision@irs.gov

FY 2011 WORKPLAN

EO Integrates – Project to Process

Through our project work, EO has developed extensive knowledge and improved skills on a wide range of subjects, allowing us to develop training materials and tools to help our staff effectively address these issues when they encounter them. It is now time to take a “project to process” approach by winding down these separate, formal projects, and assimilating them into our general casework. Below are the brief descriptions and reporting results of some of the projects that we are merging into our overall process.

- *Combined Annual Wage Reporting – The “CAWR” Project.* In FY 2007-2010, EO took a close look at employment tax reporting by exempt organizations using CAWR data, which compares information reported to the Social Security Administration (SSA) on Form W-2 with information reported to the IRS by employers on Form 941. EO CAWR populations consisted of approximately 4,000 organizations each year. Using CAWR, EO was able to identify organizations that reported wages on their W-2s but had not filed Form 941; other organizations showed officer compensation on Form 990, but had not filed Forms W-2 or 941, and non-501(c)(3) organizations that had not filed Form 940 to report and pay federal unemployment tax. (Section 501(c)(3) organizations are exempt from this tax.)

This project helped EO improve case selection and focus examination resources on organizations with high potential for non-compliance.

- *Consumer Credit Counseling Project.* One of EO’s most complex and wide-ranging efforts has been its multi-year focus on consumer credit counseling organizations. Throughout the course of this project, the IRS developed enhancements to its tax-exempt Examination program and refined its Determinations program to better identify potential abuses.

During the initial phase of the project, the IRS examined the 63 largest credit counseling organizations, based on their revenues. The IRS revoked, terminated or proposed revoking the exemptions of 41 of these organizations.

In light of high levels of abuse, we sent questionnaires to the remaining organizations that appeared to be involved in credit counseling activities. EO examined the most egregious, and has revoked, terminated, or proposed revocation of over 59 percent of the group to date. This project helped to stimulate the Pension Protection Act law change, in which Congress strengthened the tax rules governing exempt credit counseling organizations.

Our experience in this area and the lessons learned prepared us to deal with a new type of organization that increased in numbers as a result of the economic downturn in the area of mortgage foreclosure assistance organizations.

- *Down Payment Assistance Project.* Traditional down-payment assistance (DPA) programs provide financial and educational assistance to low-income homebuyers who cannot afford to make the minimum down payment on a home or to pay the closing costs involved in obtaining a mortgage. Traditionally, these tax-exempt homeowner assistance programs are funded through grants or contributions from the general public, use accepted eligibility criteria to ensure that recipients are low-income individuals, and conduct financial counseling and educational activities to prepare potential homebuyers for the responsibilities of home ownership.

The IRS began to see a rise in applications for tax exemption from organizations that varied from the traditional DPA model by relying solely on service fees and payments – often referred to as “donations” – from builders and homesellers to fund their activities. In 2006, the IRS issued a revenue ruling holding that such seller-financed DPA programs primarily serve the private interests of home sellers by funneling down-payment assistance from sellers to buyers through self-serving arrangements. The revenue ruling further held that DPA organizations structured in this manner do not accomplish a primary charitable purpose and should not receive or be able to maintain 501(c)(3) tax exemption.

EO examined those DPA organizations that were funded solely by homesellers, and revoked, terminated or proposed revocation for 87 of 91 organizations.

To prevent additional seller-financed DPA organizations from obtaining tax-exempt status, EO initiated a screening program to identify applicants that planned to conduct DPA activities, and required them to answer detailed questions about their proposed activities to determine whether they were eligible for tax exemption. Of the nearly 600 DPA applications reviewed, over half were denied, closed for failure to respond, or withdrawn.

In 2008, Congress passed legislation prohibiting the use of down-payment assistance programs funded by those who have a financial interest in the sale in order to qualify for FHA insured mortgages.

- *Executive Compensation Compliance Initiative: Loans Project.* In 2004, the Internal Revenue Service, through the Exempt Organizations Office of the Tax Exempt and Government Entities Division (EO), implemented the Executive Compensation Compliance Initiative (the Project). A report

discussing the results was issued in March 2007. That report raised concerns about substantial loans to officers, directors, trustees and key employees with issues involving proper reporting and potential excess benefit issues. Consequently, we opened the Loans Project; the report is what follows.

The loan project began with 200 compliance checks and 50 single-issue examinations. Based upon the results of the compliance checks, additional organizations were selected for single-issue examinations for a total of 169 examinations.

The issues identified in these examinations include the following:

- Assessment of over \$5.5 million in section 4958 taxes.
- Assessment of over \$480 thousand in employment taxes reported on Form 941 and Form 945 for items of income not previously reported for disqualified persons and other employees.
- Assessment of over \$400 thousand in discrepancy adjustments for omitted income on Form 1040.
- Agents determined that loans to officers were not correctly reported on Form 990 in 91 instances. The errors were predominantly due either to misclassification on the balance sheet or to section 4958 adjustments.

The results of the 169 examinations were as follows:

Examination Results	# of Orgs	% of Total
No Change	37	22%
Written Advisory Issued	75	44%
Change or Delinquent Return Secured (Including Related Returns)	39	23%
Proposed Revocation or Termination	18	11%
Total	169	100%

The information gained from the Loans Project will be valuable as we continue to evaluate compensation in future projects.

- *Investment Income – IRC 501(c)(7) Compliance Project.* Investment income – interest on bank deposits, stock dividends, royalties and the like – is generally non-taxable for many types of exempt organizations. This is not true for section 501(c)(7) organizations (social clubs), whose income is taxed unless it comes directly from a member of the club, or has been “set aside” for certain charitable purposes.

EO reviewed Form 990 filings from section 501(c)(7) organizations to determine whether some were reporting investment income, but not reporting income on Form 990-T or paying the tax, and examined over 80 organizations. We secured delinquent Forms 990-T and collected the tax,

revoked the tax-exempt status or changed the subsection of 60 percent of the examined organizations.

- *Non-Exempt Charitable Trust Project.* Although not exempt under section 501(a), a non-exempt charitable trust (NECT) must devote all of its assets and income to charitable purposes, according to the terms of its trust document. The grantor can claim a charitable deduction for contributions of money or other assets placed into the trust.

A NECT has unique filing requirements. Because it is a trust, it must file Form 1041 and pay tax on its taxable income. However, because of its charitable purpose, it is subject to many of the same restrictions and excise taxes as section 501(c)(3) organizations, and it must file either a Form 990 or 990-PF.

Because some organizations were filing Forms 990 or 990-PF but not Form 1041, EO sent compliance check letters, seeking the missing returns or an explanation as to why they were not required.

Some older NECTs proved that they were established before 1969, when the regulations permitted “setting aside” amounts earmarked for charitable contributions, eliminating the Form 1041 filing requirement. Others were determined to have been misclassified in IRS records or had applied for and received tax exemption. The remaining entities filed the required returns and paid the delinquent tax, or were referred for further examination.

The chart below details the findings of the compliance check letters:

	Number
Eligible for set-aside deduction	125
Filed correct returns	10
Required examinations	15
IRS classification corrected	20

- *Political Activities Compliance Initiative (PACI).* This initiative addressed allegations of prohibited political campaign activities by 501(c)(3) organizations.

Treasury and the IRS issued a revenue ruling to educate section 501(c)(3) exempt organizations about permissible and impermissible activities in the political arena. Additionally, EO updated Publication 1828, *Tax Guide for Churches and Religious Organizations*. EO also provided guidance about

political activities in public presentations, including the IRS Nationwide Tax Forums and *Tax Talk Today*, the IRS web-based program for practitioners.

In addition to guidance and education, EO has examined over 250 organizations based on allegations of political activity during the 2004, 2006 and 2008 federal election years. EO substantiated the allegations in over half of the examinations and closed most of these with a warning to comply with the ban on political activities in the future. EO revoked the tax-exempt status of seven non-compliant organizations.

The chart below tracks the most common types of PACI allegations: *

ALLEGATION	2004	2006	2008
1. Exempt organization distributed printed documents supporting candidates.	24	14	24
2. Church official made a statement during normal services endorsing candidates.	19	14	47
3. Candidate spoke at an official EO function.	11	16	2
4. Organization distributed improper voter guides or candidate ratings.	14	8	3
5. Organization posted a sign on its property endorsing a candidate.	12	13	11
6. Organization endorsed candidates on its website or through links on its website.	15	11	16
7. Organization official verbally endorsed a candidate.	8	5	2
8. Organization made a political contribution to a candidate.	7	11	12
9. Organization allowed a non-candidate to endorse a candidate during a speech at the organization function.	4	2	1
10. Other	0	16	15
TOTAL	114	110	133

* Because the majority of complaints for the 2010 election year came in during the later part of the year, they are still going through the classification process, so they are not included in the chart.

As we move review of allegations of political campaign intervention from project to process, the guidance and expertise developed over the past few election cycles will enable us to continue to handle these allegations appropriately, both at the classification stage and through the examination process.

- *Qualified State and Local Political Organizations (QSLPO) Project.* In 2002, Congress enacted legislation creating a sub-category of IRC section 527

political organizations known as Qualified State and Local Political Organizations, or QSLPOs. These organizations were required to notify the IRS of their “QSLPO” status by electronically filing Form 8871. This status exempts them from the requirement to file Form 8872.

After the law change, approximately 3,600 organizations identified themselves as QSLPOs and stopped filing Forms 8872.

In response, EO launched the QSLPO project to ascertain the accuracy of these organizations’ claims. EO identified a statistically valid sample of QSLPOs and sent each one a compliance questionnaire.

Overall, our findings indicate that organizations are correctly identifying themselves as QSLPOs and therefore have no Form 8872 filing requirements.

- *Supporting Organizations- The 509(a)(3) Compliance Project.* Supporting organizations (SOs) are charities that carry out their exempt purposes by assisting other exempt organizations, usually other public charities. The key feature of an SO is a strong relationship with the organization that it supports.

Prior to the Pension Protection Act of 2006, some promoters encouraged individuals to establish and operate SOs for their own benefit. Some of these scenarios involved purported charitable contributions made to the supporting organization, which were then returned to the donor, often in the form of a loan. To disguise this abuse, the transaction was sometimes routed through intermediary organizations controlled by the promoter.

EO took a two-pronged approach to combat this abuse. First, EO issued new instructions to Determinations agents to identify potentially noncompliant SOs at the application stage. Then, over the span of the project, EO selected over 300 organizations for examination; of the 280 examinations closed thus far, 30 were terminated, 72 had their exempt status revoked and 59 were reclassified as either private foundations or public charities.

The Pension Protection Act drastically changed the legal landscape and rules regarding the operation of supporting organizations. Congress imposed additional restrictions on certain types of SOs and addressed certain abuses.

In light of what we have learned through the various enforcement activities discussed above, the resources we have developed for our staff and the public, and changes resulting from legislation, we are winding down separate projects and incorporating them into overall compliance processes.

EO Supports and Collaborates

Support of IRS Initiatives – This year, EO will support five overarching IRS focus areas:

- *Impact of Recent Legislation.* With the passage of several pieces of legislation, EO is working with the whole of IRS to implement effective changes and laws.
 - The Affordable Care Act (ACA) was enacted on March 23, 2010. It contains certain tax provisions that take effect this year and more that will be implemented during the next several years.

Several provisions, primarily those involving tax-exempt hospitals and exempt organizations as employers, fall under the purview of EO.

Each of the EO offices has a role in putting together a comprehensive program to implement the changes and fulfill ACA requirements. Customer Education and Outreach (CE&O), working with the other IRS Communication offices, will educate the public on those aspects of the ACA impacting exempt organizations; Rulings & Agreements will analyze new legal issues raised by the legislation, work with Chief Counsel and Treasury on related guidance, and coordinate with other IRS offices to implement appropriate form changes; Determinations anticipates an increase in tax-exempt applications; and Examinations will establish a separate EOCA group to focus on healthcare-related compliance issues.

- The Hiring Incentives to Restore Employment (HIRE) Act was signed into law on March 18, 2010. The legislation identified tax-exempt organizations as employers eligible to claim the payroll tax exemption and new hire retention credit for eligible newly-hired employees.

Beginning in July 2010, the EOCA began conducting examinations of these credits claimed under the HIRE Act.

- The American Recovery and Reinvestment Act (ARRA) established a 65 percent subsidy on COBRA health insurance premiums to help workers who lost their jobs as a result of the recession maintain their employer sponsored health insurance.

The Continuing Extension Act of 2010, enacted April 15, reinstated the ARRA COBRA subsidy, which had expired on March 31.

Employers, including tax-exempt organizations other than churches and some religious organizations, were required to provide COBRA coverage to eligible individuals who pay 35 percent of the COBRA

premium. Employers were reimbursed for the other 65 percent by claiming a credit for the subsidy on their Form 941 or Form 944. Employers, including tax-exempt organizations, are required to maintain supporting documentation for the claimed credit.

EO will be examining the employment tax returns of organizations claiming the credit for the subsidy.

- *International Focus.* International tax enforcement is an ongoing priority for the IRS. Taxpayers with international activities, transactions and accounts pose unique compliance issues for the IRS. Globalization of markets, taxpayers and transactions affect all segments of our economy, including the exempt sector.

EO's concern in this area is whether charitable assets of exempt organizations are being diverted internationally for non-charitable purposes. We have efforts underway that will explore:

- foreign entities receiving IRS recognition of exemption from US tax;
- information referred from the Joint International Tax Shelter Information Center (JITSIC);
- charities reporting foreign addresses on Forms 990;
- charities that participate in "Gifts-in-Kind" programs, where valuation issues surface when charities send non-cash items to foreign organizations; and
- large private foundations with international operations or international transactions.

To help educate the sector, EO is developing new publications describing the special rules that apply to both foreign charities and domestic charities that conduct activities abroad.

- *Medical Residents.* IRS worked with Government Entities, the Chief Counsel's Office, Wage & Investment, Small Business/Self-Employed and the Social Security Administration to develop a comprehensive program to except medical residents from FICA (Social Security and Medicare tax) taxes based on the student exception for certain tax periods.

Beginning in May 2010, the Service began contacting hospitals, universities and medical residents who filed FICA refund claims, in order to provide them with additional information and procedures for obtaining their refunds.

- *National Research Program – Study of Employment Tax Returns.* IRS estimates employment tax misreporting constitutes a large part of the tax gap—close to \$54 billion per year. In light of this sizeable amount, the Service has updated its understanding of compliance in this area and has implemented a comprehensive IRS-wide study to measure compliance,

improve IRS ability to detect and reduce non-compliance, and ensure the fairness of the tax system. Specifically, the National Research Program (NRP) project looks at employment tax on both taxable and tax-exempt organizations, large and small businesses, and the government sector.

Because tax-exempt organizations have the same responsibilities as for-profit businesses to properly classify workers and report and pay employment taxes, EO has been participating with other IRS operating divisions in the NRP.

EO's portion of the project involves examining the employment tax returns of 1500 organizations, with 500 selected randomly each year over a three-year period. Specific areas of interest during the examinations are worker classification, fringe benefits, officer compensation, employee expense reimbursements, and non-filers. Tax year 2008 returns are currently being examined, and examinations of tax year 2009 returns will begin in early FY 2011.

The results of this project will contribute toward developing and refining Servicewide procedures for auditing, processing and resolving employment tax return cases.

- *Non-filer Initiatives.* The goals of the IRS' Servicewide Non-filer Strategy are to:
 - Help taxpayers understand and meet their filing obligations;
 - Improve voluntary compliance by reducing taxpayer burden;
 - Leverage technology to identify non-filers; and
 - Effectively use enforcement resources to deter non-filers.

EO will pursue several avenues to help support this Servicewide effort. Working with the TE/GE Research Office, we are collecting data about organizations with erratic filing patterns. To begin this effort, the EOCA will conduct compliance checks on intermittent filers in early FY 2011.

Collaboration With External Stakeholders – Collaborating with external stakeholders and leveraging their resources makes us more efficient and improves the final product. For FY 2011, we have planned the following joint efforts:

- *Academic Institutions Initiative.* In 2009, EO established its Academic Institutions Initiative to work with educational entities that work to develop, cultivate and promote professionals who shape the non-profit sector. Our goal is to help prepare the non-profit leaders of the future by providing consistent training about federal tax law responsibilities.

A September 2009 kick-off meeting generated a number of helpful ideas from educational institutions. In FY 2010, EO began implementing those recommendations by placing resources for educators on StayExempt.IRS.gov, co-sponsoring workshops for small and mid-size exempt organizations with universities, and identifying and collaborating with existing educational networks, such as the National Association of Schools of Public Affairs and Administration (NASPAA) and the Nonprofit Academic Centers Council (NACC).

In FY 2010, CE&O hosted its first-ever workshop for small and mid-size 501(c)(3) organizations in conjunction with an academic host institution. In FY 2011, CE&O will continue to expand its partnerships with existing educational networks across the country. At least eight additional similar workshops have been scheduled for the first half of FY 2011.

Also in FY 2011, CE&O will develop a page on IRS.gov specifically geared toward educators. Additionally, we will begin offering an internship program for graduate students whose concentration lies in nonprofit leadership and management. The graduate student internship program will broaden our reach to interact with a new generation of non-profit leaders. EO hopes to gain a better understanding of current nonprofit education while offering students the chance to deepen their knowledge base and become familiar with Federal tax provisions that govern exempt organizations.

- *Gaming Non-Filer Project.* Beginning in 2007, EO secured information from 17 state gaming regulatory tax agencies to cross-reference with its own Form 990 database. We discovered a large number of organizations had filed at the state level in order to maintain eligibility to continue gaming activities, but had not filed Form 990 with the IRS.

In response, we initiated examinations and have thus far secured over 1,300 delinquent returns in the cases closed. These include information, tax and employment returns.

EO will continue to expand its cooperative efforts with state regulators to identify organizations conducting gaming activities that may have federal filing requirements, and educate these organizations about their filing obligations

EO Invests

EO will continue to invest time in both new and ongoing initiatives in order to keep up with the ever-changing exempt organization sector. With these initiatives, EO will touch a broader audience of exempt organizations.

- *Controlling Organizations- The IRC §512(b)(13) Project.* The tax treatment of payments between controlled entities and their controlling tax-exempt parent organizations touches on several areas of tax law including unrelated business income, the allocation of income and deductions among taxpayers, and the transfer of property to controlled organizations.

PPA 2006 made changes to the tax treatment of certain payments from a controlled entity to its exempt parent. The IRS is gathering information on this issue through the Colleges and Universities project and other exam initiatives. The information collected will give us a better understanding of the prevalence of 512(b)(13) and related issues.

- *Charitable Spending Initiative.* This is a study to learn more about sources and uses of funds in the charitable sector and their relationship to the accomplishment of charitable purposes. Under the first phase of this project, organizations selected for examination include those with high levels of fundraising expenses, organizations reporting unrelated trade or business activity with relatively low levels of program service expenditures, organizations with high ratios of officer compensation in comparison to program service expenditures, and organizations with low levels of program service expenditures in comparison to total revenue. These examinations began in FY 2010 and will continue into FY 2011.
- *Colleges and Universities.* In September 2008, EO sent 400 questionnaires to public and private four-year colleges and universities asking about their unrelated business income, endowments and executive compensation practices. The goal is to gain a better understanding of one of the largest, most complex segments in our sector and identify issues and areas that may need more outreach and education or further scrutiny. EO analyzed the responses and an interim report was published in May 2010. The interim report contained preliminary information on the respondents' organizational structures, demographics, exempt and unrelated business activities, endowments, executive compensation and governance practices.

In addition, over 30 entities are undergoing examinations that focus on unrelated business income and compensation practices. Because some of the issues under consideration may affect other areas of TE/GE (specifically, Employee Plans and Federal State and Local Governments), we are coordinating with those offices when appropriate, along with utilizing engineering assistance.

- *Exempt Organizations Services and Assistance (EOSA)*. The objective of EOSA research project is to study the communications preferences and educational needs of small tax-exempt organizations and to develop a targeted multi-year outreach plan to provide improved education and outreach services to these organizations.

CE&O, working with TE/GE Research, initiated this project which involves three phases: 1) focus groups; 2) a quantitative analysis based on telephone surveys; and 3) a cost-benefit analysis.

- *Form 990-N Mis-filers*. The Pension Protection Act of 2006 added the Form 990-N filing requirement to ensure that the IRS and potential donors have current information about exempt organizations. Small tax-exempt organizations whose annual gross receipts are normally \$25,000 or less may be required to electronically submit Form 990-N, also known as the e-Postcard, unless they choose to file a complete Form 990 or Form 990-EZ. The failure of an organization that is required to file a Form 990 series return for three consecutive years results in automatic revocation of the organization's exempt status.

The objective of this project is to identify organizations that incorrectly file the Form 990-N.

- *Form 990 as a Compliance Tool*. The Form 990 is the IRS' primary tool to increase transparency and to promote and enforce compliance with Federal tax law. The recent design brings the Form 990 into the 21st century, reflecting changes in the tax-exempt sector and the tax law. It helps secure fuller, more relevant compliance data and provides a more comprehensive picture of each filing organization.

As more organizations file the redesigned Form 990, EO Examinations will use the updated form to identify non-compliant and potentially non-compliant organizations for examination, to develop targeted compliance projects and to inform and supplement educational efforts.

In FY 2011, EO will continue to work with our research office to develop more robust risk models and refine compliance queries to promote a more finely-tuned compliance approach and more tailored education efforts.

- *Governance*. Starting in FY 2010, EO began using a check sheet to capture governance practices and the related internal controls of the organizations being examined. EO will analyze the data over the long term to gain a better understanding of the intersection between governance practices and tax compliance.

- *Mortgage Foreclosure Assistance.* Over the past few years, there has been an increase in foreclosures, as well as exempt organizations that have become involved in foreclosure assistance activities. This project is modeled after the successful EO credit counseling project that took place several years ago. EO is developing enhancements to its examinations program and refining its determinations program to better identify potential abuses in the system.

The focus of the project will be to determine whether organizations are engaged in foreclosure assistance activities, whether their activities are fulfilling their exempt purpose in accordance with the Internal Revenue Code section under which they are recognized as tax-exempt, and whether they are complying with the requirements of section 501(q) of the Code (when applicable).

- *“Mutual” Organizations- The IRC §501(c)(12) Project.* Organizations exempt under section 501(c)(12) include benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, or cooperative telephone companies. An organization that performs any comparable service can also qualify.

These organizations must use their income solely to cover losses and expenses, with any excess being returned to members or retained for future losses and expenses. They must collect at least 85 percent of their income from members for the sole purpose of meeting losses and expenses. The results of the member-income "test" determine the organization's yearly filing requirement. An organization should file Form 990 for the years in which it meets the 85 percent member-income test, and it should file Form 1120 for the years in which it fails to meet the test.

The Forms 990 filed by some section 501(c)(12) organizations indicate that these organizations are not meeting the 85 percent member-income test every year. To address this issue, questionnaires were mailed to affected organizations in early FY 2010, and 40 percent of the questionnaire respondents were selected for examination. In FY 2011, we will begin conducting these examinations.

- *Section 501(c)(4), (5) and (6) Organizations.* In recent years, our examination program has concentrated on section 501(c)(3) organizations. Beginning in FY 2011, we are increasing our focus on section 501(c)(4), (5) and (6) organizations. With the additional information available on the new Form 990, we will look at issues including political activity, inurement and the extent of compliance with the requirements for tax exemption by organizations that self-identified themselves as a section 501(c)(4), (5) or (6) organization

- *Voluntary Employees' Beneficiary Associations (VEBAs)*. A voluntary employees' beneficiary association is defined under Internal Revenue Code section 501(c)(9) as an organization designed to pay life, sick, accident and similar benefits to members, their dependents or designated beneficiaries as long as no part of the net earnings of the association inures to the benefit of any private shareholder or individual.

Working with EP and IRS Counsel, EO developed a project to learn more about VEBAs and their compliance under this section of the code. In FY 2010, EO developed training materials and initiated its training program. These activities will continue during FY 2011. EO Examinations will begin a statistically valid sample of 100 organizations with assets greater than \$100,000 in FY 2011.