



Greetings:

FY 2011 was as busy and demanding a year for Exempt Organizations (EO) as it was for most of the exempt sector. EO faced shifts in leadership, began to move much of our work from project to process, and implemented new federal requirements that affect many thousands of exempt organizations. It was important to us to accomplish those goals while continuing to deliver the services and results that our exempt stakeholders expect from us.

That experience will be put to good use in FY 2012. Budget constraints continue to test federal agencies and exempt organizations alike. EO remains committed to providing quality service and, like most exempt organizations, we are looking at new and alternative means to get the job done.

We are shifting from print publications to electronic versions that can be downloaded by anyone, anywhere, any time, and can be updated and adjusted quickly and efficiently. We are relying more on the Internet and are continually improving our systems and offerings to help the exempt sector with easily accessible, timely information and educational content. We are working closely with academic institutions to produce our popular workshops for small and medium-size organizations, expending fewer resources while achieving greater geographical diversity and community involvement.

We also have worked to smooth the transition for small exempt organizations who now must meet filing requirements enacted by Congress. The Pension Protection Act automatically revokes exempt status for organizations that have not filed for three consecutive years. In FY 2011, EO took a number of steps to provide transition relief for small organizations and to continue to educate them about the new rules.

FY 2011 also marked the end of the three-year phase-in of the redesigned Form 990, *Return of Organization Exempt From Income Tax*. Gross receipt and asset levels that define who must file the full Form 990, 990-EZ or 990-N are now set. For EO, this means the lead-up time is over, and the redesign has begun to pay off by providing us with more information about exempt organizations. This allows us to use data analytics and build risk models that will guide our work and greatly improve our ability to support high standards of transparency and stewardship among exempt organizations.

As always, we look forward to working with our partners and stakeholders in the year ahead.

Sincerely,

Lois G. Lerner

Lois G. Lerner
Director, Exempt Organizations



Organizational Information

EO Staffing

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

The EO Examinations office (Exam) promotes compliance by analyzing operational and financial activities of exempt organizations. Exam develops processes to identify areas of noncompliance, develops corrective strategies, and coordinates with other EO functions to ensure compliance.

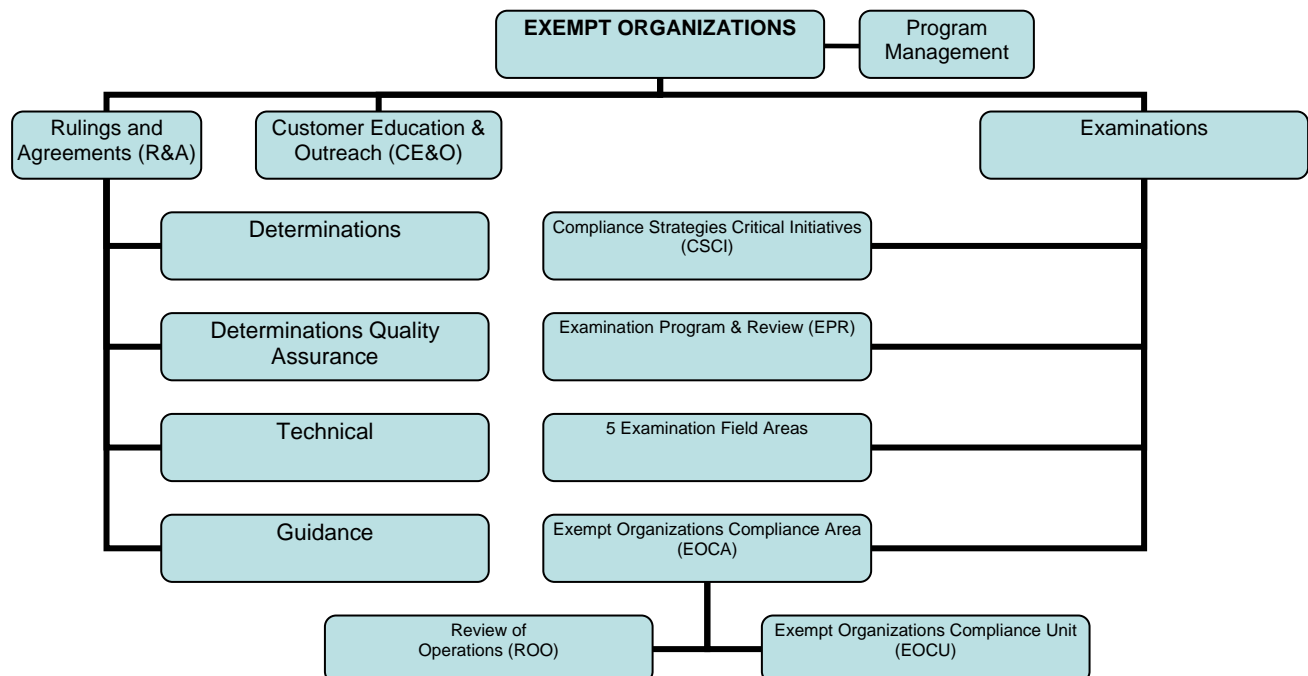
The EO Customer Education and Outreach office (CE&O) coordinates, assists and supports the development of internal and external communications, forms and publications and external education and outreach efforts.

Figure A: Table of EO on-roll employees over a 3-year period

| | Rulings & Agreements | Examinations | Customer Education & Outreach | Director's Office | Total |
|--------------|----------------------|--------------|-------------------------------|-------------------|-------|
| 2009 | 366 | 525 | 8 | 11 | 910 |
| 2010* | 337 | 538 | 13 | 12 | 900 |
| 2011 | 332 | 531 | 12 | 14 | 889 |

*2010 adjusted figures.

Figure B: Organizational chart for IRS Exempt Organizations

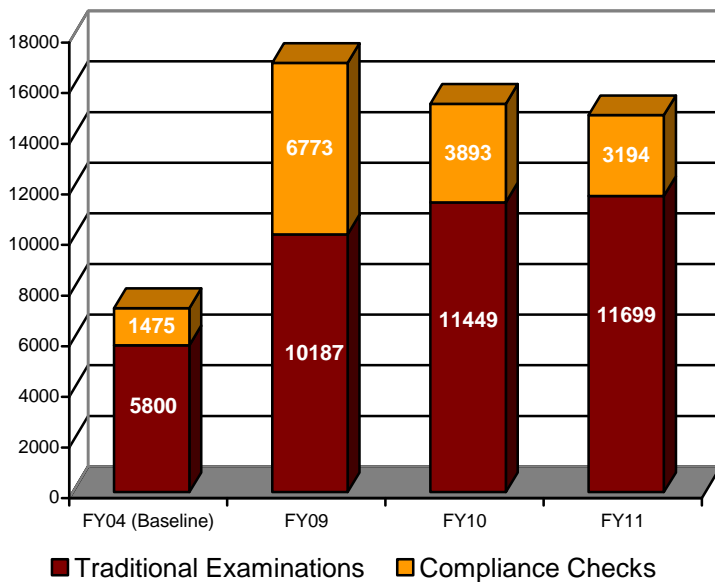


Compliance

In addition to our regular compliance work in FY 2011, EO dedicated resources to two significant efforts—working to resolve FICA refund claims for qualified medical residents and initiating hospital community benefit reviews as mandated by the Patient Protection and Affordable Care Act (ACA). In spite of these additional responsibilities, EO continued to maintain a strong compliance presence, as the chart below illustrates.

Figure C displays the total number of returns reviewed in FY 2011, including traditional examinations and the less resource-intensive compliance checks.

Figure C: Total number of returns reviewed



EO Examinations

Over the past couple of years we've been taking a fresh look at Customer Satisfaction survey results and considering things we can do to make the exam process less burdensome for our taxpayers. We've implemented several improvements that we hope will result in a more positive examination experience. I'd like to share a couple of them with you. In addition to the Fast Track Settlement process discussed in the box below, we have a new EO Examinations unit located at the Ogden Service Center that is dedicated to resolving problems, like misapplied payments or incorrect imposition of penalties, arising from examinations of exempt organizations. Also, we have been giving "plain language" updates to some of our examination letters and adding contact information for the exam agent's group manager in case organizations or their representatives wish to elevate their questions or concerns. EO Examinations will continue to focus on customer service improvements in FY 2012.



Nan Downing
Director, Examinations

EO continued to pilot the Fast Track Settlement (FTS) program. FTS is administered by Tax Exempt and Government Entities (TE/GE) and Appeals and provides an expedited process for the IRS and taxpayers to resolve disputes at an early stage using an Appeals official as a neutral party. By resolving disputes before a formal appeal is filed or the parties go to court, FTS represents a significant time and cost savings to all EO stakeholders.

Rulings and Agreements

In FY 2011, much of EO Rulings and Agreements' focus was on implementing and providing guidance on significant pieces of legislation including the Affordable Care Act provisions affecting exempt organizations, and the automatic revocation reinstatement process created by the Pension Protection Act of 2006 (PPA).

In addition, EO updated, consolidated and finalized guidance that provides vital information to stakeholders. EO worked with Chief Counsel and Treasury on the following:

Regulations

- Notice of Proposed Rulemaking (Prop. Reg. §301.6104(c)-1), which revised the rules on disclosure to state charity regulators, reflecting changes made to section 6104(c) by the PPA. EO coordinated extensively with the National Association of State Charity Officials to reduce barriers to states' participation in the information-sharing program; and
- Finalizing the regulations implementing the revised Form 990 (Treas. Reg. 1.170A-9(f) and 1.509(a)-3.). Among other measures, the regulations eliminate the burdensome two-step process for a new organization to be recognized as a publicly supported charity.

Revenue Procedures

- Rev. Proc. 2011-10, which updated a 35-year-old revenue procedure on how to obtain a determination on public charity classification and converted it to an annual revenue procedure in order to provide a mechanism for more regular updates;
- Rev. Proc. 2011-33, which updated a 29-year-old revenue procedure that provides grantors and contributors with reliance on Publication 78, *Cumulative List of Organizations* adds provisions permitting reliance on the EO Business Master File, and incorporates the new automatic revocation provisions, and;
- Rev. Proc. 2011-15, which increased the Form 990 filing threshold from \$25,000 to \$50,000 and consolidated many of the exceptions from filing Form 990 into a single revenue procedure.

EO also developed a new form, Form 8940, *Request for Miscellaneous Determination*, which makes the submission of nine categories of individually written requests for miscellaneous determinations more expeditious and the processing of such requests more efficient.

EO Rulings and Agreements

As part of our ongoing effort to streamline the determinations process, we have shifted from paper processing of applications to an electronic case processing system. This system was initially tested on small groups of determinations cases. Based on the success of these tests, we decided the system was ready for use with a broader cross-section of EO Determinations customers. In FY 2011, this system was rolled out to all EO Determinations cases. As is often the case with new electronic systems, we have experienced glitches that slowed our process, but we are confident that those will be resolved and the system will have a positive impact on the determinations process.



David Fish
Acting Director, Rulings and Agreements

Education

EO maintained its core educational activities while continuing to produce targeted outreach products. In FY 2011, EO's Customer Education and Outreach office:

- Completed the first two stages of a research effort to learn more about customer needs, including a survey of more than 1,200 small tax-exempt organizations.
- Offered new interactive educational material to help the public understand the automatic revocation process and worked with other IRS offices to make sure that the most current list of organizations automatically revoked is available on IRS.gov.
- Created a landing page for the Affordable Care Act (ACA) on the 'Charities and Nonprofits' pages of IRS.gov that consolidated all EO-related ACA information.
- Launched the Academic Institutions Initiative Summer 2011 Graduate Student Internship pilot program, including soliciting and receiving more than 30 applications and creation of a 10-week internship program in EO's Rulings and Agreements office.
- Introduced a seminar at the 2011 Nationwide Tax Forums entitled *A Day in the Life of an Exempt Organization's Audit* that walks through the particulars of EO exams.

Figure D gives an overview of numbers of stakeholders reached through EO's outreach work in FY 2009, 2010 and 2011.

Figure D: EO education and outreach efforts

| Outreach Efforts | FY 2009 | FY 2010 | FY 2011 |
|--|-----------|-----------|-----------|
| EO Update subscribers | 101,730 | 130,176 | 183,516 |
| Attendees at speeches, Tax Forums, webinars, and workshops | 47,483 | 32,111 | 41,252 |
| HIRS.gov/eoH web site views | 4,994,022 | 5,333,380 | 5,242,943 |

Customer Education and Outreach

I'm pleased and excited to be the new director of Customer Education and Outreach. It's a wonderful opportunity to work with Lois and all of my colleagues to serve the exempt community. Using CE&O's micro site, *stayexempt.irs.gov*, and other media, we're going to push hard in FY 2012 to do more of what we do best – inform, explain and educate.



Melaney Partner
Director, Customer Education and Outreach

Recognizing that webinars offer a free, convenient way to get information on important topics using the Internet, EO produced the following three outreach webinars in FY 2011 for the staffs of tax exempt organizations and tax practitioners:

- **Starting Out Right: What New 501(c)(3) Organizations Need to Know** (November 18, 2010)
- **Starting Out Right: What New NON-501(c)(3) Organizations Need to Know** (February 11, 2011)
- **International Activities of Domestic Charitable Organizations** (August 4, 2011)

Most webinars are posted on the IRS Video Portal [Hwww.irsvideos.gov](http://www.irsvideos.gov)

FY 2012 WORK PLAN

EO's Work Plan outlines the focus areas where we are deploying resources in FY 2012. These projects are in addition to EO's permanent determinations and examinations responsibilities, including ongoing process work, as well as referrals.

I. Legislative Implementation

In FY 2012, EO will continue to implement new legislation.

Auto-Revocation for Non-Filers

The Pension Protection Act of 2006 (PPA) required that almost all tax-exempt organizations file an annual return or notice with the IRS every year, and provided that any organization that does not file a required return or notice for three consecutive years automatically loses its tax-exempt status. The PPA required the IRS to publish and maintain a list of revoked organizations.

EO worked hard to prepare for implementation of the automatic revocation requirements. On June 8, 2011, the IRS published the first list of revoked organizations. The list is updated monthly as organizations with different fiscal year-ends fail to file for a third consecutive year. The list also is updated as needed to remove organizations listed in error. As of November 2011, the list totaled about 380,000 organizations.

The list is available on the IRS website in three formats. There are two searchable formats (Adobe Acrobat and Excel) for each state, the District of Columbia, and all others (international), and a composite ASCII text file of all organizations. The list, in all formats, includes each organization's name, Employer Identification Number (EIN), last known address, subsection of exemption, effective date of automatic revocation and the date it was added to the list.

In early January 2012, EO incorporated the revocation list into **Select Check** (<http://apps.irs.gov/app/eos/>), a new online application that consolidates three separate search pages into a single entry point.

Users can find out whether an organization:

- is eligible to receive tax deductible charitable contributions (Pub. 78 data)
- has had its tax exempt status automatically revoked
- has filed a Form 990-N annual electronic notice (e-Postcard)

Using Select Check, auto-revoked organizations can be searched and sorted by name, EIN, city, state, zip code, country, exemption type and revocation posting date. Select Check also provides more consistent, timely updates of the auto-revocation list and Pub. 78 data, which are now updated simultaneously once a month.

Automatically revoked organizations receive a letter from the IRS informing them of their loss of tax-exempt status and providing guidance on where to go to learn more. IRS.gov includes a wealth of that information. This includes guidance to assist revoked organizations that want to reinstate their tax-exempt status. Notice 2011-44 provides the general rules for applying for reinstatement of tax-exempt status (including requests for retroactive reinstatement) until regulations under the new PPA provisions are enacted. Notice 2011-43 and Rev. Proc. 2011-36 provide transition relief for certain small tax-exempt organizations, which allows them to pay a reduced application fee of \$100 and regain their tax-exempt status retroactive to the date of revocation.

EO is already processing reinstatement applications and as of the beginning of fiscal year 2012, more than 5,000 organizations have taken advantage of the transition relief for small organizations.

The IRS continues to send notices to organizations to remind them of their filing responsibilities. In addition, EO continues to update its customer outreach and educational materials to offer ongoing informal guidance and address new issues relating to the automatic revocation program, such as updating applicable FAQs on the IRS website (www.irs.gov).

Requirements for Tax-Exempt Hospitals

The Affordable Care Act of 2010 (ACA) added new requirements that tax-exempt hospitals must meet to maintain their tax-exempt status. The IRS is required to review the community benefit activities of hospital organizations at least once every three years. Accordingly, EO Exam formed and trained a Review of Operations group dedicated to completing the statutorily required community benefit reviews which began in March 2011. These reviews are not examinations and the group does not expect to contact hospitals while conducting the reviews. As we move forward, EO will use the information gathered from the reviews for research, reporting and compliance purposes, as well as to identify areas where additional guidance, education or Form 990 changes are needed. The IRS issued Notice 2011-52 in July 2011, to address the Community Health Needs Assessment requirements and related excise tax and reporting obligations applicable to tax-exempt hospitals. We continue to work with Treasury and Counsel to develop guidance on the new Section 501(r) requirements.

Section 501(c)(29) Organizations

The IRS issued Notice 2011-23 in March 2011, to provide guidance on the requirements for tax exemption under Section 501(c)(29), which created a new type of exempt organization (Qualified Nonprofit Health Insurance Issuers), and annual filing requirements for organizations described in that section. Revenue Procedure 2012-11, issued in conjunction with temporary regulations and a notice of proposed rulemaking in February 2012, sets out the procedures for issuing determination letters and rulings on the exempt status of organizations applying for recognition of exemption under Section 501(c)(29).

Accountable Care Organizations

In March 2011, the IRS issued Notice 2011-20, which summarized how the IRS expects existing guidance may apply to Section 501(c)(3) tax-exempt organizations, including tax-exempt hospitals, that participate in the Medicare Shared Savings Program through accountable care organizations (ACOs). The Notice was part of a multi-agency

coordinated effort. The IRS recently issued Fact Sheet 2011-11 to provide additional information for charitable organizations that may wish to participate in the Shared Savings Program.

Reporting Requirements

EO implemented changes to Form 990 to accommodate new reporting requirements under the ACA for tax-exempt hospitals and 501(c)(29) Qualified Nonprofit Health Insurance Issuers. In addition, Schedule H (Form 990) was revised to add new Part V(b) to address the new 501(r) requirements for tax-exempt hospitals. Form 990-T was revised to allow eligible tax-exempt employers to claim the small employer health care tax credit under 45R.

II. Compliance: Using the Form 990

The IRS redesigned the Form 990 to promote transparency and compliance. The new form, which was effective in tax year 2008, has provided EO with a wealth of information on exempt organizations. EO has used this information to develop risk models to assess the likelihood of noncompliance by organizations, allowing more effective use of examination resources. In FY 2012, EO will incorporate information from the revised Form 990 in the following activities.

501(c)(4), (5) and (6) self-declarers

These groups – social welfare organizations; labor, agricultural and horticultural groups; and business leagues, such as a chamber of commerce – can declare themselves tax-exempt without seeking a determination from the IRS. EO will review organizations to ensure that they have classified themselves correctly and that they are complying with applicable rules. In FY 2012, EO will send a comprehensive questionnaire to organizations based on Form 990 filings to assess compliance in this area.

Political activity

As in any election year, EO will continue its work to enforce the rules relating to political campaigns and campaign expenditures. In FY 2012, EO will combine what it has learned from past projects on political activities with new information gleaned from the redesigned Form 990 to focus its examination resources on serious allegations of impermissible political intervention. As in the past, information from outside sources about political campaign intervention will be reviewed by a committee of career civil servants. In addition, other potential violations identified through risk modeling of Form 990 data also will be sent to the committee for evaluation. The committee will focus on identifying the cases to refer for examination. EO will further refine its risk models based on the results of examinations. EO will also ensure reporting and payment compliance with section 527(f).

990-T and UBIT

In FY 2012, EO will be looking at organizations that report unrelated business activities on Form 990 but have not filed a Form 990-T. In addition, we will analyze Form 990-T data to develop risk models that will help us identify organizations that consistently report significant gross receipts from unrelated business activities but declare no tax due. EO will use this work in connection with a coming UBIT project.

Governance

The new Form 990 has given the IRS a great deal of information about organizational governance practices. In FY 2012, the IRS will be using this data to look at connections between certain governance practices and tax compliance.

III. Collaborative Efforts

Much of EO's work is collaborative, involving external stakeholders as well as our colleagues and counterparts elsewhere in the IRS. This year, we will build on existing collaborative projects, including the international project, the National Research Program's Study of Employment Tax Returns, and the Academic Institutions Initiative. We also will work with others in our division on a new project to streamline the examinations information on the 'Charities and Nonprofits' page of IRS.gov.

International

Globalization affects all parts of our economy, including the exempt sector. Many tax-exempt organizations, in order to accomplish their charitable purposes, are moving money, people and goods across U.S. borders. EO's focus is whether assets of exempt organizations that are dedicated for charitable purposes internationally are being diverted for non-charitable purposes. To look at this, EO has collaborated with our counterparts elsewhere in the TE/GE division, as well as other business units of the IRS.

In FY 2011, EO formalized its partnerships with outside entities to gather international data and information. We worked with the Joint International Tax Shelter Information Center, the Canadian Revenue Agency and agencies in other countries on tax information exchanges. We also supported offices within the IRS, including the Large Business and International division Global High Wealth Industry.

In FY 2012, we will continue to examine exempt organizations that operate overseas to ensure that those activities are consistent with their charitable purposes. This will include a number of large private foundations that have international activities with assets or total annual revenue greater than \$500 million. We will be looking at compliance issues unique to private foundations, such as self-dealing, failure to distribute income, excess business holdings, jeopardy investments and taxable expenditures.

In addition, we will continue to look at organizations that report ownership of a foreign bank account to determine:

- Whether the organization maintains adequate books and records to ensure assets are used for charitable purposes,
- Whether the organization has maintained proper discretion and control over funds that have left the United States,
- Whether the organization has met all filing requirements, and
- How foreign operations or grantmaking furthers the organization's exempt purpose.

Finally, to assist foreign and domestic charities involved in overseas activities, EO plans to release two new publications describing the special rules that apply to both.

Academic Institutions Initiative

In 2009, EO established the Academic Institutions Initiative to collaborate with educational entities that educate and develop professionals who will shape the nonprofit sector. Our goal is to help prepare the nonprofit leaders of the future by providing consistent training about federal tax law responsibilities.

In FY 2011, EO produced its workshop program for small and medium-sized (SMS) nonprofit organizations and collaborated with nine universities to host the programs. These institutions – ranging from community colleges to law schools to university-based professional development programs – offered SMS workshops to their faculty, students and nonprofit and practitioner communities. The collaborative approach – with schools providing the venues and handling logistics – was overwhelmingly successful and in FY 2012, all SMS workshops will be associated with academic institutions.

In FY 2012, EO also will continue projects started in FY 2011, including a summer internship program for graduate students interested in careers in the nonprofit sector and an Educator’s Resource Page for the “Charities and Nonprofits” section on IRS.gov.

National Research Program

The IRS-wide National Research Program (NRP) looks at employment tax matters involving taxable and tax-exempt organizations, large and small businesses, and the government sector. The results of this project will inform improvements to IRS procedures for auditing, processing and resolving employment tax return cases. EO’s portion of the project involves examining the employment tax returns of 1,500 organizations, with 500 selected randomly each year over a three-year period. EO will continue to work on NRP in FY 2012, the third and final year of the project, focusing on completing all remaining exams and providing data for the overall IRS report.

EO Examinations Resource Page on IRS.gov

In FY 2012, EO Customer Education and Outreach will work with EO Examinations to provide a central resource page for exempt organizations on IRS.gov. Posted content will help organizations understand what they can expect during a compliance check or an examination by clarifying the various steps in the process and providing direct links to related resources that are available elsewhere on the website.

IV. General Work

EO also will be working on these projects in FY 2012:

Colleges and Universities

EO is completing a wide-ranging review of this important part of the tax-exempt sector. Information from a compliance questionnaire sent to 400 colleges and universities was summarized for the public in an interim report in May 2010. EO is working to further analyze questionnaire data and to complete examinations of selected colleges and universities. A final report will highlight EO’s findings drawn from the questionnaire data and exam results.

Disaster Relief Communications

Disasters at home and abroad often prompt an immediate effort from the exempt community to raise and distribute funds for relief. Unfortunately, disasters also present

opportunities for organizations to abuse the tax law. In FY 2012, EO CE&O will coordinate with EO Examinations and R&A to identify specific compliance issues that are most commonly associated with disaster relief efforts, and will develop a communications plan to help educate new and existing organizations about the rules and responsibilities in this area. We want to help groups provide relief to those in need without engaging in activities that may cause them to be penalized or jeopardize their exemption.

Group Rulings

The Advisory Committee on Tax Exempt and Government Entities (ACT) issued a report on group exemptions in June 2011. EO will continue the analysis of the group exemption issue begun by the ACT by developing a questionnaire to be sent to a cross-section of group ruling holders. The questionnaire will explore the practices used by the central or parent organization to meet the requirements of Rev. Proc. 80-27, and will include questions about the methods used to satisfy annual filing requirements. In addition, based on our experience with the auto-revocation process, EO plans to expand educational efforts for group ruling members.

Mortgage Foreclosure Assistance

As residential foreclosures have mounted, the IRS has seen the number of exempt organizations involved in foreclosure assistance activities rise, as well. In FY 2012, both Determinations and Examination will focus on the activities of these organizations to determine whether they are fulfilling their exempt purpose, and whether they are complying with the requirements of section 501(q) of the Code.

State-Sponsored Workers Compensation Organizations – 501(c)(27)s

In FY 2012, EO will review the activities of a number of state-sponsored groups that provide workers compensation insurance and claim exempt status under Section 501(c)(27). We will contact these organizations to determine whether they are meeting the criteria for exemption, are correctly classified as exempt, and are paying any employment taxes due.

Private Foundations

Many private foundations hold substantial assets, and private foundations generally are subject to more restrictive rules than other charities. Based on information reported on the Form 990-PF, EO is examining a selection of the largest private foundations.

EO Services and Assistance

In 2010, EO launched a research project to learn how small tax-exempt organizations receive tax-related information and how EO can develop more effective, efficient outreach and education programs for them. The research is in three phases – focus groups, a telephone survey and a cost-benefit analysis – among organizations drawn from the EO Master File. Participants included representatives from 501(c)(3) organizations with less than \$200,000 in gross receipts and less than \$500,000 in assets (based on Tax Year 2010's filing thresholds).

Focus groups conducted in October and November 2010 provided qualitative feedback, in small group settings, about thoughts, attitudes and emotions. These sessions helped determine the topics and questions for subsequent telephone surveys. The phone surveys conducted in March and April 2011 gave EO quantitative, statistically

projectable information. The third and final research stage, a cost-benefit analysis in FY 2012, will correlate taxpayer preferences and EO outreach efforts and measure cost effectiveness.