



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

November 4, 2004

Dear Colleagues, Members of the Press and Taxpayers,

In Fiscal Year 2004, the IRS Exempt Organizations division (EO) set four broad strategic priorities to guide our workplan for the year. These priorities were to:

- improve understanding of and compliance with applicable tax laws,
- reduce the burden of compliance,
- improve operational efficiency, and
- protect the public interest by providing access to disclosable information.

EO made significant progress in each of these areas in FY2004. Our workplan for the coming year will build upon the foundation laid by these accomplishments, balancing enforcement and service to improve compliance. Before describing the specifics of that plan, let's look at some of our accomplishments.

***FY2004 Accomplishments***

**Improve understanding and compliance.** Ensuring that the tax-exempt community understands and complies with applicable tax laws and regulations is crucial for maintaining public confidence and fairness in tax administration. Some of the initiatives launched in 2004 supporting this priority included:

- Credit Counseling Compliance Project;
- Identifying and Combating Abusive Tax Avoidance Transactions (ATAT);
- Anti-terrorism Activities;
- Tax Exempt Compensation Enforcement Project;
- Fundraising Expenses Education Project;
- IRC Section 527 Political Organizations Compliance Project;
- Published Guidance:
  - *Revenue Ruling 2004-51*: provided guidance regarding ancillary joint ventures of section 501(c)(3) organizations.
  - *Notice 2004-35*: proposed regulations excluding income distributions from trusts and estates from a private foundation's net investment income under IRC section 4940.
  - *Notice 2004-36*: proposed regulations excluding private foundations from the requirement to include the income portion of distributions from section 4947(a)(2) split-interest trusts in determining the distributable amount under section 4942.
  - *Notice 2004-12*: proposed regulations and revenue procedure regarding student FICA exceptions.

- *Notice 2004-30*: identified abusive tax avoidance transactions (ATAT) involving S Corporations.
- *Revenue Ruling 2004-6*: provided guidance regarding public advocacy activities of tax-exempt organizations described in sections 501(c)(4), 501(c)(5) or 501(c)(6).

**Reduce the burden of compliance.** Ensuring compliance and maintaining the integrity of the tax system will necessarily impose certain burdens on all taxpayers. TE/GE is committed to reducing the cost of customers interacting with the Service while also minimizing the need to do so. EO initiatives to reduce the burden and cost of compliance in 2004 included:

- *Modernized e-File (MeF)*. MeF was successfully launched on February 23, 2004, enabling tax-exempt organizations to file their annual Forms 990, 990 EZ, 1120 POL, and the extension Form 8868 electronically.
- *EO Workshops*. EO offered 18 “Small and Mid-sized Exempt Organization Workshops” and five “Applying for Tax Exempt Status Workshops” to the public. In addition, EO participated in the IRS Tax Forums, offering workshops on the application process and seminars on the “Do’s and Don’ts for Churches and Other 501(c)(3) Organizations” and “Tips for Completing the Form 990.”
- *Improved Internet Presence*. EO improved the structure and accessibility of the Charities and Non-Profit pages on IRS.gov. For example, EO added:
  - *Life Cycle of a Public Charity*. This guide provides easy access to IRS forms and compliance guidance for charities from inception to ongoing operations and compliance.
  - *CPE Articles*. An index, hyperlinked to all CPE articles, helps the public research training materials.
  - *Published Guidance*. This new page helps the reader locate EO revenue rulings, regulations, revenue procedures and notices.
- *Plain-Language Publications Issued*.
  - Applying for 501(c)(3) Tax-Exempt Status (Publication 4220).
  - Compliance Guide for 501(c)(3) Tax-Exempt Organizations (Publication 4221).
  - A Charity’s Guide to Car Donations (Publication 4302).
  - A Donor’s Guide to Car Donations (Publication 4303).

**Improve operational efficiency.** To succeed in accomplishing its mission, TE/GE must build a qualified and satisfied workforce, and provide that workforce with access to timely and accurate customer information. In 2004, EO made significant adjustments to work practices and organizational structure aimed at improving efficiency and business results.

- Flat funding levels combined with rapid growth in the tax-exempt sector in recent years have resulted in understaffing and historically low examination levels in EO. To reverse this trend, EO hired more than 70 new revenue agents in the last quarter of the fiscal year; training for these new hires will conclude in the second quarter of FY 05.
- *Exempt Organizations Compliance Unit (EOCU)*. The new EOCU addresses areas of noncompliance and improves the information provided on EO tax returns by using correspondence, reaching and impacting a greater number of exempt organizations than would be possible through traditional audits. Approximately 10,000 organizations were contacted in FY2004.

- *Data Analysis Unit (DAU)*. This new unit uses databases and information to investigate emerging compliance trends to improve the identification and selection of casework for EO.
- *Team Examination Program (TEP)*. EO completed the migration from the Coordinated Examination Program (CEP) to the Team Examination Program (TEP). This program establishes a dedicated large case staff under one manager, allowing for a flexible examination approach and better prioritization of resources to meet the needs of complex organizations.
- *Dedicated Determination Screening Group*. This group leverages the knowledge base of EO's most experienced agents to improve efficiency in screening applications for exemption; by centralizing all screenings in this core group, consistency is improved and greater clerical processing savings are realized.
- *Filing to Closure*. A team was established to review EO's examination processes and make recommendations for improving the quality of the returns selected for examination and reducing the time from filing a return to conclusion of an examination. The recommendations of this team will be implemented in FY 2005.
- *TEGE Determinations System*. A team was established to review EO's determinations process and develop a system to streamline this process. This project continues in FY 2005.

**Provide disclosable information to the public.** EO has a unique responsibility to protect the public interest by making certain information about the tax-exempt community public. The following programs facilitate public review; such monitoring of exempt activities promotes voluntary compliance and helps to preserve the integrity of the tax system.

- *Modernized E-filing*. MeF addresses the need for faster and more complete data on exempt organizations, significantly reduces Form 990 submission error rates, and makes publicly disclosable EO data available sooner for both the public and law enforcement.
- *Federal/State Liaison Efforts*. In order to improve our services to our state partners, EO developed a new procedure to facilitate information sharing under IRC Section 6104(c).

### ***FY2005 Priorities***

In recent years, the IRS as a whole, and EO in particular, have focused on improving customer service and education as a means to improving voluntary compliance with the tax code. Significant progress has been made in the service area, and we now must balance customer service with an enforcement program to stem the growing tide of abuses within the tax-exempt community. Building a stronger enforcement presence is EO's top priority in FY2005.

Establishing an enforcement presence includes focusing on critical enforcement initiatives, as well as enhancing our limited resources through improving business processes, leveraging resources through improved coordination with other IRS operating divisions and the states, and by improving workload identification and selection systems.

EO's four critical enforcement initiatives and planned actions for FY2005 are summarized briefly as follows:

## **1. Anti-Terrorism.**

- EO Examinations will examine a sample of returns to determine the effectiveness of controls put in place to monitor the distribution of overseas grants and other assistance.
- EO Examinations will establish a Fraud and Financial Transaction Unit (FFTU) to address complex financial fraud cases.
- EO Rulings & Agreements (R&A) will provide training in EO law and technical assistance as needed to Criminal Investigations (CI), various Treasury and inter-agency governmental task forces and other governmental personnel.
- EO R&A will monitor information provided through the determination process that would help identify organizations that are potentially involved in supporting terrorist efforts.
- EO Electronic Initiatives will develop a data acquisitions strategy for EO, determining data needs to support Anti-Terrorism, ATAT, and other compliance efforts, and facilitating acquisition of data sources.

## **2. Abusive Tax Avoidance Transactions.**

- EO Examinations will lead cross-functional teams to examine and address perceived abuses by and of tax-exempt organizations, including IRC Section 509(a)(3) supporting organizations, IRC Section 501(c)(15) entities and Producer-Owned Reinsurance Companies (PORC), donor-advised funds and organizations involved in HUD programs.
- EO R&A will issue appropriate guidance on ATAT issues. It will also continue to use and refine its newly developed “Touch and Go” (TAG) program to identify cases early in the determination process that may involve abusive transactions, and to ensure consistent application of tax law.

## **3. Credit Counseling.**

- EO examination activity, initiated in FY 2004 and covering over half of the gross receipts of this market segment, will continue into FY 2005 in coordination with state Attorney General offices, the Federal Trade Commission and other operating divisions.
- EO R&A will rigorously review applications from consumer credit organizations seeking exempt status and continue to provide technical expertise to EO Examinations for the Credit Counseling Compliance Project.

## **4. Excessive Compensation.**

- The Tax Exempt Compensation Enforcement Project will continue, with approximately 2,000 compliance check letters sent, and examinations of selected returns completed, by year-end.
- Coordination with SB/SE and LMSB will ensure that related income tax return issues are dealt with appropriately.

In addition to, and in support of, the specific activities described above, EO will engage in a coordinated, cross-functional effort to improve compliance through a strengthened enforcement

presence, enhanced data collection and screening, and more complete, targeted communications with our partners and customers.

- **EO Examinations.** In FY 2005, EO Examinations will focus on the four critical initiatives stated above: anti-terrorism, emerging abusive tax avoidance issues, credit counseling and excessive executive compensation, and will continue to work other important cases and projects with the balance of its resources. In addition, EO Examinations will finalize implementation of the Data Analysis Unit (DAU), develop new projects for the Exempt Organizations Compliance Unit (EOCU) and implement the Fraud and Financial Transaction Unit (FFTU).
- **Rulings & Agreements.** FY 2005 activities will reflect enhanced coordination between EO Examinations and R&A in support of the enforcement priority. The new Dedicated Determinations Screening Group will improve screening of applications for exemption, allowing for closer scrutiny of applications by organizations with a high risk of non-compliance, such as credit counseling organizations, and identification of promoters of tax avoidance schemes and organizations that inappropriately use their tax-advantaged status for personal gain, earlier in the application process.
- **Electronic Initiatives.** EO Electronic Initiatives will place emphasis on expanding the Modernized e-File Program to include Forms 990-PF and 990-T and the development of an Interactive Form 1023 (aka “Cyber Assistant”), which will allow exempt organizations to fulfill their filing and public disclosure requirements more quickly and easily.
- **Customer Education & Outreach.** In addition to complementing our enforcement efforts, education and outreach to exempt organizations and tax professionals regarding their reporting and tax responsibilities continues to be a priority. EO CE&O will seek to expand the reach of its customer education programs by establishing stronger relationships with nonprofit and tax practitioner trade associations, improving our online presence and developing new outreach tools, such as an e-mail listserv, while continuing to invest in the “plain language” publications, workshop and speaker programs.
- **Forms Revision.** Through the leadership of EO R&A, EO will implement significant form revisions in FY 2005. The revised Application for Recognition of Exemption (Form 1023) is scheduled to be released in the first quarter of FY 2005. The new form, including a checklist that pinpoints the basic qualification requirements and improved schedules, will help ensure organizations seeking exemption meet all requirements before exempt status is approved and facilitate a smoother, more efficient process for reviewing applications for exemption. Similar changes will be considered for Form 1024.

The emphasis on enforcement in FY 2005 will help to stem the proliferation of abuses in the tax-exempt community and promote voluntary compliance. However, enforcement must be balanced with customer service, including streamlined business practices, enhanced use of automation tools and timely guidance.

EO's balanced approach encompasses service and enforcement, guidance, outreach and education to improve voluntary compliance with tax-exempt law. In the coming months, EO will continue to streamline our business operations to improve efficiency and results, establish stronger relationships with the federal, state and local regulatory bodies that oversee the tax-exempt sector, and improve the internal governance of the sector. Improving our ability to identify trends and abuses earlier in the process will support our enforcement efforts, while reducing the burden of compliance by helping us to better target our examination resources.

Sincerely,

Martha Sullivan  
Director  
Exempt Organizations

FY 2005  
EXEMPT ORGANIZATIONS  
(EO)  
IMPLEMENTING  
GUIDELINES

The Mission of Exempt Organizations is to provide Exempt Organizations customers top quality service by helping them to understand and comply with applicable tax laws, and to protect the public interest by applying the tax law with integrity and fairness to all.

November 2004

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## EO EXAMINATIONS

### OVERVIEW

The Director, Exempt Organizations (EO) Examinations supervises the activities of EO Examination Programs and Review (EPR), the six EO Area Offices and Compliance Strategies and Data Analysis, and reports to the Director, Exempt Organizations. EPR includes the examination support functions: Examination Planning and Monitoring, Classification, Mandatory Review, Special Review and Examinations Special Support. The six Area Offices, located in various geographical areas, include group managers and examination specialists. Compliance Program projects and the Data Analysis Unit (DAU) are supervised by the Manager, Compliance Strategies and Data Analysis.

The TE/GE Strategic Plan calls for improving the IRS presence in the tax-exempt community to promote greater overall compliance and fairness. EO activities and programs in 2005 will seek to improve compliance through enforcement and education, restore public trust in charitable organizations and help those organizations establish the strong internal governance structures required to prevent future abuse. In support of these themes, EO has allocated resources in its FY 2005 examination plan to those areas of greatest compliance risk to the tax-exempt community. These strategic operational priorities are:

1. Combating abusive tax avoidance transactions (ATAT), with special emphasis on earlier identification of abusive schemes and enforcement in identified transactions;
2. Anti-terrorism efforts;
3. The excessive compensation initiative;
4. Credit counseling; and
5. Improving business results and customer service.

#### **1. Abusive Tax Avoidance Transactions (ATAT)**

Although the majority of tax-exempt organizations carry out their valuable role in full compliance with the letter and spirit of the law, abusive tax schemes can involve various types of tax-exempt organizations. Whether initiated by organization insiders or by third parties using the cover of charitable purposes to avoid paying their fair share of tax, such activity undermines confidence in our voluntary compliance tax system as well as public support for charitable giving, a unique and important feature of our society. A major priority of EO's Examination Plan is to deter abusive tax avoidance transactions (ATAT), including emerging issues, that exploit the benefits of tax-exempt status for personal gain.

- **IRC Section 501(c)(15) Entities and Producer-Owned Reinsurance Companies (PORC):** Section 501(c)(15) of the Internal Revenue Code provides tax exemption for small non-life mutual insurance companies. Although new legislation effective for tax years beginning after December 31, 2003 (calendar year 2004) amended the code to address these abuses, this change does not impact the compliance or enforcement activities for years prior to enactment. This has been listed on EO's ATAT website as a potentially abusive transaction, triggering disclosure requirements for taxpayers and organizations engaged in such transactions. A cross-functional group is addressing

several perceived abuses in the Section 501(c)(15) and Form 1120 areas. LMSB is assisting in converting revoked forms 990 to forms 1120.

- **Donor-Advised funds:** Donor-advised funds allow private donors to provide input as to how their charitable contributions will be spent. A number of organizations have come to light through examinations, referrals from other parts of the IRS, and public scrutiny which appear to have abused the basic concepts underlying donor-advised funds. These organizations, while promoted as legitimate donor-advised funds, appear to be established for the purpose of generating questionable charitable deductions, providing impermissible economic benefits to the donors and their families (including tax-sheltered investment income for the donors), and providing management fees for the promoters. EO Examinations will identify organizations with a high potential for abuse in this area and commence examinations during FY 2005.
- **IRC Section 509(a)(3) Supporting Organizations:** A number of cases have been identified where promoters are using supporting organizations in abusive tax avoidance schemes. These schemes include tax-exempt support organizations that do not own or control their assets, have made large loans to the founder or supported organization trustees, do not have independent trustees, and do not provide the support for which they obtained exemption. EO began a cross-functional examination and enforcement effort with SB/SE in FY 2004, which will continue into FY 2005.
- **Housing and Urban Development (HUD):** In response to referrals from HUD concerning abuse by individuals setting up exempt organizations for the purpose of participating in a number of HUD programs, EO initiated a compliance project in this area in FY 2004. Potential abuses include lack of charitable activity, personal use of program property, and most often, private benefit provided to for-profit construction contractors hired to complete the repairs to program properties. In these cases, contractors were usually related to the organizations' officers or board members, and were often the same individuals. Costs were over-stated and work was sub-standard or completely lacking. The project is currently focusing on abuses by exempt organizations in HUD's housing rehabilitation/resale and down payment assistance programs, and will expand to other HUD programs as staffing permits.

## 2. Anti-Terrorism

EO Examinations jointly participates with EO R&A in EO's support of government-wide anti-terrorism activities. In FY 2005, examinations of organizations making foreign grants will continue, while a new team will be established to address complex financial transactions.

- **Foreign Grants:** The compliance strategy coordinating committee has developed a strategy to measure and monitor compliance with expenditure responsibility by public charities making grants or distributing funds outside the United States. In FY 2005, EO will examine a sample of foreign grant making organizations; the primary focus of the examinations is to ensure that funds are used for their intended charitable purpose and not diverted for terrorist activity. The project will gather information about current practices,

that is, the existence and effectiveness of controls put in place to monitor the distribution of overseas grants and other assistance. This committee will also address the need for possible guidance or other modifications to the laws in this area.

### **3. Excessive Compensation Initiative**

The Tax Exempt Compensation Enforcement Project was established to address the issue of potentially excessive compensation paid to insiders of charities and private foundations. The initiative addresses how compensation is determined and reported, loans to employees, “deals” between employees and organizations, compensation as compared to assets, and whether the excess benefit box was checked on the return or not. In FY 2005, the EOCU will continue to mail letters for compliance checks, and the field will initiate examinations of other entities. By project completion, approximately 2,000 contacts will have been made, and examinations of selected returns completed; a report on the initiatives will be completed during the first quarter of FY 2006.

### **4. Credit Counseling/Consumer Credit Services**

Addressing abuse in the credit counseling industry is one of EO’s highest priority projects. As IRS Commissioner Mark Everson testified before both houses of Congress, the focus of the credit counseling industry has shifted over the past several years from providing educational or charitable services to marketing debt management plans. It appears that not all of these organizations continue to meet the legal standards for tax-exempt status; for example, they are not providing meaningful education or counseling.

This fosters an environment in which the consumers who go to these organizations for assistance are easily taken advantage of and left with little recourse. In FY 2004, EO began an initiative to address this significant compliance problem. The project committee pursued strategies to address: inurement/private benefit issues in credit counseling services, issues related to consumer credit services that operate as commercial businesses, and issues related to possible sham organizations established as part of a tax shelter promotion. Entities accounting for over half of the gross receipts in this market segment were under examination at the end of FY 2004. EO is actively coordinating consumer credit counseling cases with LMSB and SBSE to address related taxable entities that require audit. EO examination activity, in coordination with state Attorney General offices, the Federal Trade Commission and other operating divisions, will continue into FY 2005.

### **5. Business Results and Customer Service**

Implementing efficient business practices and creating an organizational structure poised for success are important factors in achieving EO’s program goals. In FY 2005, EO Examinations will continue and expand upon the work begun in previous years to realign the organization for optimal efficiency.

- **Filing to Closure Project:** In FY 2004, TEGE undertook the reengineering of the examination process in EO and EP by establishing the Filing to Closure (FTC) Project to

review the processes and make recommendations for improvements. The FTC team focused on four broad initiatives aimed at improving the quality of returns selected for examination and reducing the time between filing and conclusion of an examination: getting the returns with the most potential to the examiners as soon as possible; conducting focused (limited scope) audits; improving communication between the taxpayer, revenue agent and group manager; and closing cases more quickly. The recommendations of the FTC project will be implemented in FY 2005.

- **Hiring and Training:** Hiring initiatives allowed EO Examinations to hire 72 new revenue agents in September 2004; training will occur in FY 2005.
- **New Organizational Structure:** Implementation of the new Examination organizational structure, designed to streamline business operations, continues in FY 2005. Three new teams, the Exempt Organizations Compliance Unit (EOCU), the Data Analysis Unit (DAU), and the Fraud and Financial Transaction Unit (FFTU), were developed to enhance EO's return selection, method of taxpayer contact and use of data.

**Team Examination Program:** Approximately 30 percent of Examination time and resources are devoted to the TEP. TEP examines the largest and most complex cases. In FY 2005, workload priorities for TEP will be aligned and first focused on the largest and most complex cases identified in our strategic priorities, beginning with those cases identified as ATAT.

**The EOCU** will address those entities with issues that do not initially require examinations, through inspection of filed returns and correspondence contacts.

**The DAU** was designed to provide trend research and analysis to improve workload selection for examinations. Its major objectives will be:

- Support compliance through identification of trends,
- Support the compliance program in achieving operational efficiencies through the use of improved case selection, and
- Identify trends and/or potential compliance issues within the EO sector through the use of the Internet, RICS, and various internal and external databases.

The Unit will consist of economists, statisticians, research analysts, at least one revenue agent on a rotational basis, and possibly an additional member to test and support the technical information systems. It is currently partially staffed with one statistician and an economist; hiring and final implementation will be completed in the first quarter of FY2005.

**The Fraud and Financial Transaction Unit (FFTU)** will be established to address complex fraud and tax avoidance cases. The unit, staffed with revenue agents, forensic accountants, classifiers, reviewers, and data miners trained to effectively address complex fraud and abusive scheme issues would provide expert assistance and work in conjunction with the Criminal Investigation (CI) Division and other stakeholders, as needed. Implementation is scheduled for April 2005.

- **Revised Form 990:** EO is revamping the Form 990 to improve its usefulness as a compliance tool and information source for the public and state taxing agencies.

## 6. General Program Coverage and Compliance Projects

In addition to the specific areas of emphasis described above, the remainder of the EO Examination plan will address general program coverage and ongoing Compliance Program activities.

**General Program Coverage:** EO Examinations casework in FY 2005 not described in previous sections of this report will include addressing referrals and claims indicating non-compliance and closing out remaining cases from FY 2004.

- **Medical/Dental Resident FICA Claims:** On February 25, 2004 proposed regulations were issued further clarifying the IRS position that medical residents do not qualify as students, but rather as employees, for employment tax purposes. EO Examinations is involved in three categories of medical/dental FICA claims: cases that have been examined by field groups, some of which will be fast tracked to Appeals or litigated; erroneous refund suits, or “Line 9 adjustment” cases; and claims suspended in classification and elsewhere pending issuance of additional guidance.

**Compliance Program:** The Compliance Program is a systematic approach to understanding and improving compliance throughout the tax-exempt community. The program is comprised of compliance projects and market segment studies.

Current project teams that are past the development phase, meaning the analysis approach has been fully developed and approved, will continue working through their implementation and analysis phases. Project teams that have not completed the development phase will only complete that phase in FY 2005 and will not begin implementation until further resources permit.

- **IRC Section 527 Organizations:** In November 2002, changes were made to the law concerning reporting requirements for political organizations, and in July 2003 the IRS launched the new 527 filing and disclosure website, enabling political organizations to electronically file required documents. During FY 2004 the Section 527 committee identified and developed strategies to test three potential non-compliance situations: Section 527 political organizations that (1) filed Form 8872 late, (2) did not fully disclose all required data on Form 8872, and (3) filed an amended Form 8872 that was materially different from the original return. The EOCU initiated implementation of this strategy by sending contact letters to noncompliant organizations; where appropriate, these contacts may result in examination. Implementation is ongoing throughout FY 2005.
- **Disaster Relief:** The focus of this compliance project will be to ensure that distributions by disaster relief organizations – both those formed in the wake of the terrorist attacks of September 11, 2001 and preexisting organizations – were made in compliance with the

Victims of Terrorism Tax Relief Act of 2001, that there is no private benefit, inurement, or fraud, and that the organizations are fulfilling their exempt purpose.

- **Gaming:** A cross-functional National Gaming Committee, including representatives from each geographic region and EO function as well as IRS Counsel, was established in FY 2002 to ensure compliance issues in the charitable gaming industry are addressed consistently and fairly nationwide. Implementation of the multi-year National Charitable Gaming Strategy and Action Plan developed by the committee in FY 2003 continues in FY 2005, including compliance and educational efforts.
- **Other Projects:** Additional compliance projects addressing non-filers, donated property, fundraising, Post-VCAP and Section 4958 non-compliance will also continue.

**Market Segment Studies:** The Market Segment approach is based on the recognition that the tax-exempt community consists of widely diverse segments of organizations with widely diverse needs. Studies are designed to measure the level of compliance within a given market segment, and to identify potential areas of non-compliance. Thirty-eight market segments have been preliminarily identified; the number and make-up of market segments will continue to be refined over time. Although the original plan included initiating studies of a few markets each fiscal year, no new market segment studies will be initiated in the coming year due to EO's focus on the critical compliance initiatives described above.

- **Private Foundation (PF) Segments:** This project was undertaken in light of what appears to be significant growth in the PF area and to continue the IRS' review of grant-making organizations. The research conducted by this team was shared with other teams who have added PF's to their initiatives. The team developed and refined its strategy during FY 2004, and in FY 2005 EO will conduct examinations and compliance checks.
- **Community Foundations:** Community foundations – which may be trusts, corporations or unincorporated associations – provide charitable support to their local communities by building endowments with contributions from local residents and drawing upon these endowments to provide grants and gifts to local charities and charitable community projects. Community foundations also administer non-endowment funds.

## **7. Initiatives and Emerging Issues**

During FY 2005, EO Examinations will continue to encourage future voluntary compliance with filing and recordkeeping requirements by placing emphasis on the issuance of Inadequate Recordkeeping Reports and the imposition of penalties for incomplete returns (for example, omitted or inaccurate information on the compensations of officers).

EO Examinations will facilitate the public's submission of referrals by creating a link on the IRS website for this purpose. The site will outline potential EO tax law violations, information needed in order to determine the merit of the allegations, suggested format, and IRS contact information.

EO Examinations' Classification section is testing a process designed to streamline the assignment of referrals connected with high-profile issues. An accelerated case processing procedure should be perfected by mid-FY 2005.

## EO RULINGS & AGREEMENTS

### OVERVIEW

The Director, EO Rulings & Agreements (R&A) administers the EO Determinations and Technical Guidance programs, including customer-initiated determination applications, private letter ruling requests, and published guidance. EO R&A also provides critical technical and professional support to both EO Examinations and EO Customer Education and Outreach.

EO R&A will support EO efforts to improve compliance through enforcement and education, restore public trust in charitable organizations and help those organizations establish the strong internal governance structures required to prevent future abuse. In support of these themes, EO R&A will:

1. Continue to lead the EO Abusive Tax Avoidance Transaction (ATAT) committee;
2. Support anti-terrorism efforts;
3. Provide technical guidance to tax-exempt organizations, including revocation standards in the critical excessive compensation initiative;
4. Promote closer inter-governmental relationships;
5. Improve business results and customer service; and
6. Provide technical support to other EO offices.

#### **1. Abusive Tax Avoidance Transactions (ATAT)**

EO R&A will serve as the Chair and Project Leader for the EO Abusive Tax Avoidance Transaction (ATAT) Committee, formed in FY 2004. The Committee seeks to identify abusive shelters as early as possible, provide information on policies and procedures, and make recommendations regarding such shelters. The Committee will coordinate with other offices within TEGE and IRS to ensure that EO's actions support IRS efforts to stop abusive transactions.

- **Touch and Go (TAG):** EO R&A will continue to use and refine its newly developed TAG program to identify cases early in the determination process that may involve abusive transactions, and to ensure consistent application of tax law.
- **Consumer Credit Counseling:** EO R&A will rigorously develop and review applications from consumer credit organizations seeking exempt status and continue to provide technical expertise to EO Examinations for the Credit Counseling Project.
- **Revised Forms:** Form 1023, *Application for Recognition of Exemption Under Section 501(c) (3) of the Internal Revenue Code*, is complete, and the new form will be available on the IRS.gov web site in the first quarter of FY 2005. The revised form will capture more information relating to abusive tax avoidance transactions. EO R&A is also supporting EO Examinations in its revision of Form 990 to also capture more information relating to abusive tax avoidance transactions.



- **Technical Assistance:** EO R&A will continue to provide extensive technical assistance on several projects involving possible abusive transactions, including, but not limited to:
  - Consumer Credit Counseling Organizations;
  - IRC 501(c)(15) Entities and Producer-Owned Reinsurance Companies (PORC);
  - IRC 509(a)(3) Supporting Organizations; and
  - Donor-Advised Funds.

## 2. Anti-Terrorism Efforts

EO R&A will provide training and technical assistance aimed at preventing charitable organizations from financing terrorism. Efforts will include:

- **Training (Internal and External):** EO R&A will provide training in EO law as needed to Criminal Investigation (CI) and other governmental personnel, as well as necessary technical assistance regarding EO law to various Treasury and inter-agency governmental task forces. In addition, EO R&A will partner with CI to deliver training internally to all front-line EO employees and managers to ensure they have the necessary skills to identify and combat financial fraud, prevent the diversion of money from charitable organizations, and address willful noncompliance within the EO customer base.
- **Inter-Governmental Technical Support:** EO R&A will provide technical assistance regarding EO law to Treasury's Office of Terrorism and Financial Intelligence and other inter-agency government task forces, will assist CI in ongoing investigations of suspect charities, and will work with CI on a project to help track connections between known or suspected terrorists/terrorist organizations and other individuals and organizations, including exempt organizations.
- **Coordinating Anti-terrorism Efforts:** EO R&A is also working with Treasury's Office of Terrorism and Financial Intelligence, state government agencies, and the National Association of State Charity Officials (NASCO) to improve federal/state coordination on anti-terrorism efforts.

EO R&A is monitoring information provided through its exemption processes against the Treasury's Office of Foreign Assets Control, Specially Designated Nationals and Blocked Persons list, and other relevant information that would help identify organizations potentially involved in supporting terrorist efforts.

- **EO Examinations Technical Support:** EO R&A will assist EO Examinations to profile foreign grant-makers to determine what oversight they engage in to ensure their assets go to charitable purposes. Based on the findings, EO may initiate further guidance or compliance actions.
- **EO FFTU Technical Support:** EO R&A will provide support to the new Fraud and Financial Transactions Unit, which will bring together fraud specialists, forensic accountants, and agents with expertise in tracking foreign grant activities. The unit will

help TE/GE provide more effective assistance to other investigative offices in identifying and working fraud and terrorist financing cases.

### **3. Guidance to the Exempt Organizations Community**

To assist the charitable community in complying with the complex tax laws governing exempt organizations, EO R&A, in conjunction with the Office of Chief Counsel and the Department of the Treasury, will develop and issue guidance to customers.

The FY 2005 Priority Guidance Plan includes:

- Guidance on down-payment assistance organizations.
- Guidance on low-income housing partnerships and section 501(c)(3) participation.
- Guidance under sections 501(c)(3) and 4958 on revocation standards.
- Guidance under section 501(c)(15) concerning producer-owned reinsurance companies.
- Guidance concerning the internet and unrelated business income tax.
- Regulations under section 529 regarding qualified tuition programs.

In addition, EO R&A, in conjunction with CE&O, will develop plain language publications to further assist the public.

### **4. Intergovernmental Relations**

EO R&A will lead EO efforts to develop closer relationships with the federal, state and local governing bodies that share responsibility for monitoring the activities of tax-exempt organizations.

- **Federal-State Relations:** EO R&A will continue to streamline and implement a revitalized state sharing program. To re-energize regulatory efforts and leverage resources, R&A will meet with the National Association of State Charitable Officials (NASCO) to identify areas of mutual interest and explore ways to more closely integrate activities and strategies, including piloting project teams that include NASCO members. EO R&A will continue program oversight of the IRC 6104(c) state notification program.
- **Legislation:** EO R&A will review and provide input on proposed legislation related to exempt organizations, in conjunction with Legislative Affairs, Counsel and Treasury. As needed, EO R&A will develop implementation plans for any new legislation.

### **5. Business Results and Customer Service**

EO R&A continues its efforts to streamline business practices, enhancing the efficiency of the application process as well as the quality of information available to the public, in FY 2005.

- **EO Determinations Applications:** The revised Form 1023, *Application for Recognition of Exemption Under Section 501(c) (3) of the Internal Revenue Code*, which includes a check sheet that pinpoints the basic qualification requirements and improved schedules,

will be available on the IRS.gov web site in the first quarter of FY 2005. The new form will enable determination agents to review applications more efficiently and will help ensure that organizations seeking exemption meet all requirements up front before exempt status is approved.

- **Form 990 Revision:** To further the goals of increased transparency and better governance, EO R&A will continue to provide technical support to the Form 990 Revision Team working on a comprehensive overhaul of the form to provide better compliance information to the IRS, the states, and the public.
- **TEGE Determination System (TEDS):** EO R&A will provide extensive technical expertise for the development of the TEDS to replace current methods for processing and tracking determination application cases.
- **Cyber Assistant:** EO R&A will provide specialized knowledge and skill for the feasibility study, and eventual development of an interactive internet application for filling out a Form 1023. The program will use a “Cyber Assistant” to guide the applicant organization through the Form 1023 by defining essential and unfamiliar terms, requiring the completion of certain information to assure the filing of a complete application, performing consistency checks, as well as referencing and linking to relevant IRS publications. This cyber education process will result in more complete and accurate applications.
- **Customer Satisfaction:** The EO Determination Customer Satisfaction Team will continue to review determination letters, notices and forms to identify opportunities to improve determination case processing.

## 6. Technical Support and Other Activities

- In conjunction with Disclosure and Counsel, EO R&A will develop and implement a comprehensive plan to address extensive new disclosure requirements mandated by the court decision in Tax Analysts v. IRS 350 F.3d 100 (D.C. Cir.2003).
- **Examinations Market Segment & Compliance Projects:** EO R&A will continue to provide extensive legal and technical expertise and support to EO Examinations in all ongoing Market Segment and Compliance Projects.
- **Customer Education and Outreach Support:** EO R&A will continue to work with CE&O to increase EO presence in the community by providing speakers for training events and conferences, as well as providing technical assistance for the development of educational material, such as plain language publications and web-site content.
- **EO Continuing Professional Education (CPE):** EO R&A will develop and provide CPE training to EO employees using various means, including CENTRA (a virtual classroom method), interactive videos (IVT), the Internal Revenue Manual (IRM) and the IRS intranet. As noted above, one key focus will be the delivery of a comprehensive

training program to all EO front-line employees and managers on fraud, terrorism & abusive schemes.

- **Advisory Committee for TEGE (ACT):** EO R&A will continue to support ACT members on their projects.

## EO ELECTRONIC INITIATIVES OFFICE

### OVERVIEW

The EO Electronic Initiatives Office (Electronic Initiatives) manages the development and implementation of EO automation efforts in support of the TE/GE Strategic Plan. The Manager, Electronic Initiatives reports to the Director, Exempt Organizations.

EO activities and programs in 2005 will seek to improve compliance through enforcement and education, restore public trust in charitable organizations and help those organizations establish the strong internal governance structures required to prevent future abuse. In support of these themes, Electronic Initiatives will:

1. Support EO efforts to enhance enforcement, combat abusive tax avoidance transactions (ATAT) and fight terrorism by improving data analysis capabilities;
2. Continue implementation of Modernized e-File;
3. Leverage technology to improve business results and customer service; and
4. Support the efforts of other EO and IRS offices.

#### 1. **Enforcement Support**

The Electronic Initiatives Office will support TEGE's goal of deterring abuse within tax-exempt entities and misuse of such entities for tax avoidance purposes by exploring opportunities to increase data availability, improve research and analytical systems, and work with other divisions to identify new data sources.

- **Data Acquisition:** In FY 2005 the Manager for the Electronic Initiatives Office will serve as the team lead to develop a data acquisitions strategy for EO, determining data needs to support Anti-Terrorism, ATAT, and other compliance efforts, and facilitating acquisition of data sources.

Accurate and complete data in a more usable electronic format will facilitate analysis of EO customer sub-segments to support both education and compliance efforts. Access to more complete data will also support IRS's efforts to identify organizations that may serve as sources of terrorist funding.

Acquisition of new information sources will also help to reduce the burden on compliant customers by focusing EO examination resources where there is the greatest compliance risk.

- **DAU, FFTU Support:** The Electronic Initiatives Office will support EO in its efforts to integrate use of data and e-commerce into the compliance process.

#### 2. **Modernized e-File**

MeF will address the need to improve the access to and quality of data to support our enforcement efforts.

The availability of electronically filed Form 990 information returns, along with continued support of the Imaging Unit for paper EO filings, will expedite the disclosure of these exempt organization filings. Electronic filing for non-profits, launched in 2004 through the Modernized e-File (MeF) Program, will be expanded in FY 2005 to include the Form 990PF for non-profits. In FY 2005, Electronic Initiatives will:

- **Develop New and Revised Forms:** Electronic Initiatives will develop and deliver the Forms 990PF and 990T in an electronic environment as part of the Modernized e-File Program, and will continue support to the Form 990 Revision Team to simplify the form and make it suitable for electronic filing.

Improvements associated with the TEDS project, including development of the electronic Form 1023 and the Cyber Assistant described in more detail below, will facilitate the disclosure of EO determination requests.

- **Single Point E-File:** Electronic Initiatives will partner with the NAAG/NASCO and representatives from the states to develop single point electronic filing.

### **3. Business Results and Customer Service**

Electronic Initiatives will leverage the benefits of technology to streamline business practices, alleviating the burden of compliance on EO customers while improving organizational efficiency and business results.

- **Cyber Assistant:** Electronic Initiatives will facilitate the feasibility assessment of developing an Internet application for the completion and filing of Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.
  - Direct the program management approach through the development of the “Cyber Assistant” program.
  - Provide support and direction to the Cyber Assistant project and the integration with the TEGE Determination System (TEDS) project.
- **Promote Awareness and Availability of E-File:** Electronic Initiatives will work with internal and external stakeholders to market the MeF Program to increase participation of preparers, filers, and the software development community and will conduct a survey of preparers and tax-exempt organizations to get feedback about electronic filing.

### **4. Support Other Initiatives**

- **EO Support:** Electronic Initiatives will provide consultation and procurement support to convert determination case file microfiche for current and historical files to images, and support the IRS strategy for effectively handling residual paper filings.

- **TEGE E-Services Strategy:** Electronic Initiatives will determine TEGE strategic direction for conducting business over the Internet. Electronic Initiatives will continue participation on the IRS E-Commerce Board and will establish partnerships with ETA and MITS E-Services Project to include TEGE's requirements in the IRS overall E-Strategy.
- **TEGE CONOPS:** Electronic Initiatives will participate in the development and delivery of the TEGE Concept of Operations (CONOPS).

## **EO CUSTOMER EDUCATION AND OUTREACH**

### **OVERVIEW**

The Director, Customer Education and Outreach (CE&O), develops the strategic direction of the nationwide education and outreach programs for EO customers. The Director, Customer Education and Outreach, reports to the Director, Exempt Organizations.

The Director, CE&O, manages a staff of revenue agents, tax law specialists, and support personnel who develop and deliver programs and products designed to assist exempt organizations understand their tax responsibilities. CE&O conducts most of its activities cooperatively with the involvement of specialists from EO Exam and R&A.

In support of EO's FY2005 focus on improving compliance, CE&O programs in FY 2005 will:

1. Support EO efforts to enhance enforcement and combat abusive tax avoidance transactions (ATAT);
2. Improve voluntary compliance through education and outreach to the exempt organizations community; and
3. Improve business results and customer service.

#### **1. Enforcement Support**

CE&O will support the EO Compliance Program through the development of education and outreach materials and coordinated communication campaigns.

- **Marketing and Communication Programs:** In FY 2004, CE&O began to develop detailed communication plans to compliment EO compliance initiatives, such as credit counseling. CE&O will continue to develop communication plans on critical exam issues in FY 2005. In addition, CE&O will develop distribution systems for any new or revised IRS publications and forms, which support the overall EO communication effort.

These plans identify internal and external audiences (representatives of exempt organizations, practitioners who work with them, the general public, IRS personnel and external government stakeholders), suggest key messages and talking points, identify appropriate communication vehicles (such as media outreach, public speaking opportunities or creating a new publication) and recommend timelines for each communication activity.



- **Support for EOCU:** CE&O continues to serve as the EO “notice clarity” review function for all of EO. CE&O will review all taxpayer communications developed or “owned” by EO. This role will continue to grow as the EO Compliance Unit (EOCU) continues to ramp up its activities.

CE&O will develop “mini-publications” that can be written, produced and distributed quickly to support EOCU initiatives; these are described in more detail below in the “Education and Outreach” portion of this report.

CE&O representatives will continue to participate on project committees, evaluate the feasibility of any outreach proposals, and select, prioritize and plan the resulting outreach or education.

## **2. Education and Outreach**

The primary focus of CE&O’s activities in FY 2005 will be education and outreach to the exempt organizations community regarding their compliance responsibilities. These activities fall into four broad categories: publications and forms, presentations, web-based programs and other communication activities.

- **Publications:** CE&O is responsible for developing and updating EO publications and forms, in conjunction with other offices within EO and IRS Forms and Publications. Through plain-language publications, CE&O supports EO’s efforts to increase the quality of information available to the public. CE&O’s proactive approach helps organizations avoid costly enforcement actions that might otherwise result from inadvertent violations.

CE&O will complete the plain-language publications initiated in FY 2004, and begin work on a limited number of new items in FY 2005, depending upon available resources. CE&O will complete the following publications started in FY 2004:

- Revision of Publication 578, *Tax Information for Private Foundations and Foundation Managers*.
- Revision of Publication 3079, *Gaming Publication for Tax-Exempt Organizations*.
- Revision of Publication 892, *EO Appeal Procedures for Unagreed Issues*.

CE&O will begin development of the following in FY 2005:

- Mini-publications that can be written, produced and distributed quickly, to make EO customers aware of new and developing issues that will impact their operations and compliance responsibilities as quickly as possible. Depending upon the topic, the mini-publications might be made available as an email, or electronically via the internet, or as a traditional printed publication
- Brochures describing limitations and restrictions of tax-exempt organizations engaged in political activity.

- **Presentations:** CE&O will continue to coordinate and oversee delivery of workshops, speeches and other presentations made by Exempt Organizations specialists. Through these activities, CE&O supports EO's efforts to improve governance and oversight by explaining tax compliance issues to staff and volunteers of exempt organizations, as well as to tax practitioners. EO's FY 2005 presentation activity will occur in the following four programs:
  - *State/Federal Co-sponsored Workshops.* In FY 2004, CE&O partnered with the state Attorneys General offices in New York and California to present "How to Apply for Tax Exempt Status" workshops. EO specialists explained the Form 1023 application process to leaders of newly incorporated organizations. The goal was to make the process easier for these leaders and the practitioners working with them, as well as improving the quality of applications received by EO's Rulings and Agreements office. Preliminary feedback on FY 2004's program from participants and the state partners is positive. Depending upon available resources, CE&O plans to partner with these two states again on this or a similar program in FY 2005, and may add new state partners.
  - *IRS Tax Forums.* CE&O plans to continue its involvement in the 2005 IRS Nationwide Tax Forums, a three-day session offered annually in six locations around the country. CE&O will propose EO seminars and workshops to be considered by the IRS' National Public Liaison office, the sponsor of the Forums. CE&O will coordinate the delivery of all EO presentations, as well as jointly sponsor a booth with other TEGE offices.
  - *Workshops for Small and Mid-size Exempt Organizations.* If resources are available, CE&O will continue to present workshops for small and mid-size exempt organizations in cities throughout the country. The workshops are designed to help leaders of these organizations understand their basic tax compliance responsibilities. Typically, these organizations cannot or do not use a tax practitioner for their interactions with the IRS.

CE&O will continue to use a private contractor to locate workshop space and to register attendees for all workshop sessions. CE&O successfully used a contractor for these functions in FY 2004.

Although the target audience is board members or volunteers of exempt organizations, tax practitioners have also begun to attend, which helps extend the reach of this program.

As in previous years, these three programs will utilize presentation materials and texts prepared by CE&O, and will be staffed by members of EO's Presenters Cadre, a group of 19 specially trained Exam, R&A and CE&O employees.

- *Individual speeches.* EO receives over 200 invitations annually to speak at meetings or conferences, on panels or at other events. CE&O provides the overall coordination of these activities by:
  - Overseeing the procedures for requesting, approving and assigning speeches;
  - Helping to prepare and edit speeches and presentations;
  - Providing information on the appropriate publications and how speakers can get them;
  - Coordinating the use of outreach equipment, such as datashows or display units.

In FY 2004, CE&O developed an intranet-based library of presentation materials available to all EO speakers, including talking points and key messages on current issues of interest to exempt organizations. CE&O will continue to add to and refine the library so that these materials are available for speakers to incorporate in presentations and outreach events where appropriate.

In FY 2005, CE&O will proactively seek speaking opportunities to further EO's FY 2005 compliance priorities, and will evaluate other speaking requests to ensure consistency with those priorities and maximize efficiency in allocation of EO's limited travel and outreach budget. Customers requesting speeches where the audience size does not meet the requirements will be referred to other educational resources.

- **Web-based Programs:** CE&O is responsible for overseeing the EO portion of both the IRS' Internet and intranet websites. CE&O recognizes that continued expansion of the quality and quantity of information on IRS.gov can help improve governance of exempt organizations, as well as support the increased enforcement efforts of EO Exam.

*Internet.* In FY 2004, CE&O maintained and developed the EO portions of [www.irs.gov](http://www.irs.gov), concentrating on improving the structure and accessibility of the Charities and Non-Profit pages. Working with the Advisory Committee for TEGE and TEGE's Communications and Liaison office, CE&O successfully launched the "Life Cycle of a Public Charity" web pages. In FY05, CE&O will launch the "Life Cycle of a Private Foundation" and continue to add material to both Lifecycle pages to develop their usefulness for EO customers. CE&O will continue its maintenance of all of the EO pages on the Internet.

*Intranet.* CE&O participated in the TEGE intranet redesign, which launched in FY 2004. CE&O continues to maintain the EO portions of the site, and has set up communication channels with other EO functions to make sure that the site contains accurate, useful information.

- **Other Communication Activities:** In addition to the specific programs described above, CE&O will continue to develop new communication vehicles to improve outreach to the tax-exempt community. Among these are:

*Communication of Legislative Changes.* Newly-enacted legislation may affect the reporting and compliance requirements of exempt organizations. CE&O will take the lead in communicating any changes in the law to the affected organizations and educating them about their new responsibilities. Such communications could involve postings on the irs.gov, mass print mailings, email, interaction with stakeholder groups, and media alerts.

*Listserv Development.* CE&O has begun to explore the feasibility of communicating via broadcast email on topics of importance to the tax-exempt community. In FY 2005, CE&O will research the requirements and costs of developing a listserv, and begin building a database of EO customers.

### **3. Business Results and Customer Service**

- **Revised Forms:** CE&O will continue support of the Forms 990 and 1023 revision teams, focusing its efforts on education and outreach to the tax-exempt community about how the revisions will impact reporting and recordkeeping requirements for exempt organizations.
- **Modernized e-File:** 2004 was the first year that exempt organizations could file Forms 990 electronically. CE&O will continue to work with the EO Electronic Initiatives office on publicizing the availability of Form 990 e-filing through contacts with stakeholders, public speeches, information on IRS.gov and other means.