

## C. Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status

In a Special Report that accompanied the Fiscal Year 2014 Objectives Report to Congress, the National Taxpayer Advocate described the management and other failures in the Exempt Organizations (EO) function that led to violations of taxpayers' rights and the inappropriate activity reported by the Treasury Inspector General for Tax Administration (TIGTA) in May of 2013.<sup>1</sup> These failures, affecting taxpayers seeking recognition of exempt status under IRC § 501(c)(4), brought to light both procedural issues (lengthy delays, excessive questioning, and intrusive document production) and substantive issues (such as the degree to which an entity may engage in political activity and still qualify as an exempt social welfare organization under IRC § 501(c)(4)).

As discussed extensively in the Special Report, EO was largely unfamiliar with TAS's role and TAS's authority to issue Taxpayer Assistance Orders (TAOs) under IRC § 7811.<sup>2</sup> In 19 TAS cases in which the IRS delayed approval of exempt status due to concerns about political activity during the period covered by TIGTA's audit, EO was not forthright in explaining why their applications for recognition of exempt status were being delayed.

The National Taxpayer Advocate made 16 recommendations to address the problems discussed in the TIGTA report as well as other conditions in EO that burden taxpayers. In this Area of Focus, we will discuss the status of each recommendation and highlight additional areas of concerns.

**National Taxpayer Advocate Recommendation 1: Clarify the level of political activity that exempt organizations may conduct, and establish an objective test to identify when an organization exceeds that level.**<sup>3</sup>

### Background

Since its inception in 1913, the federal income tax has provided for exempt status for organizations organized and operated "exclusively" for charitable or general welfare purposes.<sup>4</sup> However, the Supreme Court in 1945 held that a single non-exempt purpose, "if substantial in nature, will destroy the exemption" (emphasis added), implying that an insubstantial non-exempt purpose would not be fatal to the tax-exemption.<sup>5</sup> In 1954,

1 National Taxpayer Advocate Special Report to Congress: *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013) [hereinafter the Special Report]; TIGTA, Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013), available at <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf> [hereinafter the TIGTA report].

2 Under IRC § 7811, the National Taxpayer Advocate or her delegate can issue a Taxpayer Assistance Order (TAO) to order the IRS to take certain actions, cease certain actions or refrain from taking certain actions. A TAO may also be issued to order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case or review the case at a higher level. Once a TAO is issued, the IRS can either comply with action ordered or appeal the issue for resolution at a higher level. IRM 13.1.20.5, *TAO Appeal Process* (Dec. 15, 2007).

3 National Taxpayer Advocate Special Report to Congress: TIGTA, Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013).

4 See Tariff Act of 1913, 38 Stat. 114 (1913).

5 *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279, 283 (1945).

Congress enacted the unrelated business income tax, confirming that exempt organizations may conduct certain non-exempt activities.<sup>6</sup>

The regulations under IRC § 501(c)(3), published in 1959, allow organizations to qualify for exempt status if they are operated “primarily” for charitable purposes.<sup>7</sup> The regulations under IRC § 501(c)(4), also issued in 1959 and applicable to social welfare organizations that must be operated “exclusively” for the promotion of social welfare, allow exempt status to organizations “*primarily engaged* in promoting in some way the common good and general welfare of the people of the community.”<sup>8</sup> Neither regulation defines or quantifies the term “primarily.”

With respect to political activity specifically, organizations exempt under IRC § 501(c)(3) have since 1934 been permitted to engage in only “insubstantial” lobbying activity, a term that appears, undefined, in the regulations today.<sup>9</sup> In 1954, exempt status was further limited in section 501(c)(3) by a prohibition against *any* participation or intervention in political campaigns on behalf of candidates for public office, a restriction not found in the statute or regulations under IRC § 501(c)(4).<sup>10</sup> Thus, by implication, section 501(c)(4) organizations can engage in some amount of political campaign activity.

In her 2013 Special Report, the National Taxpayer Advocate noted that

[i]n the absence of clear, publicly disclosed criteria to determine whether organizations are (or are not) engaged in too much political campaign activity to qualify as tax-exempt under IRC § 501(c)(4), the IRS may not be able to make decisions in an objective and consistent manner. Even if it can, it may not be *perceived* as making decisions in an objective and consistent manner.<sup>11</sup>

### *The IRS Safe Harbor for IRC § 501(c)(4) Organizations*

In July of 2013, the IRS began issuing Letter 5228, *Application Notification of Expedited 501(c)(4) Option*, to certain organizations whose applications for recognition of exempt status under IRC § 501(c)(4) indicated the organizations could potentially be engaged in political campaign intervention or be providing private benefit to a political party, and whose

6 IRC § 511 et seq.

7 See Treas. Reg. § 1.501(c)(3)-1(c)(1).

8 IRC § 501(c)(4)(A); Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (emphasis added).

9 See Revenue Act of 1934, Pub. L. No. 73-216, § 101(6), 48 Stat. 680, 700 (1934), recognizing exempt status for an organization “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes” only if “[n]o substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation,” a provision still in effect; Treas. Reg. § 1.501(c)(3)-1(b)(3)(i), providing that an organization “is not organized exclusively for one or more exempt purposes if its articles expressly empower it: (i) To devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise.” See below for a discussion of IRC § 501(h), providing an alternative to the “no substantial part” standard for electing organizations.

10 Internal Revenue Code of 1954, 68A Stat. 163, sec. 501(c)(3), providing that a charity may “not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office,” a provision still in effect.

11 National Taxpayer Advocate Special Report at 15.

applications had been outstanding for 120 days as of May 28, 2013.<sup>12</sup> The letter offered a “safe harbor” to these organizations if they could certify that:

1. They devote 60 percent or more of both their spending and time (including volunteer time) to activities that promote social welfare as defined by section 501(c)(4). Activities that promote social welfare do not include “direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office;” (campaign intervention); and
2. Campaign intervention amounts to less than 40 percent of both their spending and time (including volunteer time).<sup>13</sup> Campaign intervention includes, among other things,
  - a. Conducting a voter registration drive *that selects potential voters to assist on the basis of their preference for a particular candidate or party;*
  - b. Conducting a “get-out-the-vote” drive *that selects potential voters to assist on the basis of their preference for a particular candidate or (in the case of general elections) a particular party;*
  - c. Preparing and distributing a voter guide *that rates favorably or unfavorably one or more candidates;* and
  - d. Conducting an event *at which only one candidate is, or (in case of a general election) candidates of only one party are, invited to speak* (emphasis added).

For purposes of the safe harbor, campaign intervention also includes any expenditure incurred or time spent by the organization on “any public communication within 60 days prior to a general election or 30 days prior to a primary election that identifies a candidate in the election.”<sup>14</sup>

Organizations providing the required certifications within 45 days of the date of the letter would receive recognition of exempt status within one month.<sup>15</sup> On December 23, 2013, the Tax Exempt/Government Entities Division (TE/GE) made the safe harbor available to all

<sup>12</sup> Tax Analyst Tax Notes Today, 2013 TNT 129-15 IRS *Provides Instructions For Optional Expedited Process For Some Tax-Exempt Applications* (July 5, 2013).

<sup>13</sup> These representations, made under penalties of perjury, regard past, present, and future activities.

<sup>14</sup> The concept of “campaign intervention” in the safe harbor is similar in some respects to activities taken into account under Federal election campaign laws. See Federal Election Campaign Act (FECA) of 1971, 2 U.S.C. 431 (20) as amended, defining Federal election activity as “(i) voter registration activity during the period that begins on the date that is 120 days before the date a regularly scheduled Federal election is held and ends on the date of the election;(ii) voter identification, get-out-the-vote activity, or generic campaign activity conducted in connection with an election in which a candidate for Federal office appears on the ballot (regardless of whether a candidate for State or local office also appears on the ballot);(iii) a public communication that refers to a clearly identified candidate for Federal office (regardless of whether a candidate for State or local office is also mentioned or identified) and that promotes or supports a candidate for that office, or attacks or opposes a candidate for that office (regardless of whether the communication expressly advocates a vote for or against a candidate); or (iv) services provided during any month by an employee of a State, district, or local committee of a political party who spends more than 25 percent of that individual’s compensated time during that month on activities in connection with a Federal election.”

<sup>15</sup> As discussed below, applications from organizations that did not respond within 45 days were reviewed pursuant to additional special procedures.

other similarly situated IRC § 501(c)(4) applicants (not only those whose applications were outstanding for a given length of time).<sup>16</sup>

TE/GE did not clear Letter 5228 with TAS pursuant to normal review procedures, nor is the National Taxpayer Advocate aware of the IRS's rationale for adopting a 60/40 ratio of social welfare to campaign intervention activity as an appropriate metric for exempt status under IRC § 501(c)(4). Members of the American Bar Association (ABA) Tax Section have in the past suggested a safe harbor of 40 percent of expenditures (*i.e.*, not taking into account the efforts of volunteer workers) for nonexempt activities.<sup>17</sup> The ABA commenters acknowledged that the IRS had never acquiesced to that standard.<sup>18</sup> Moreover, much of the analysis about the statutory requirements regarding what activities are eligible for tax-exemption occurs in the context of unrelated business taxable income (UBIT).<sup>19</sup> As at least one writer noted, "the IRS requirements for exemption and UBIT relatedness may be conflated in practice."<sup>20</sup> In any event, we note that since the 2004 ABA suggestion, the U.S. Supreme Court decided *Citizens United v. FEC*, which may have increased the number of groups engaged in political activity seeking exemption under IRC § 501(c)(4).<sup>21</sup>

### *The Proposed Treasury Regulation under IRC § 501(c)(4)*

On November 29, 2013, the Treasury Department and the IRS requested public comment on a proposed regulation that would provide guidance to tax-exempt social welfare organizations on political activities related to candidates that will not be considered to promote social welfare.<sup>22</sup> Neither the IRS nor Treasury shared this proposed regulation with the National Taxpayer Advocate, her staff, or her counsel for comment prior to submitting it to the Federal Register for publication, nor was the National Taxpayer Advocate consulted during the

16 See Interim Guidance, TE/GE-07-1213-24, *Request for EO Technical Assistance* (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5B1%5D.pdf>. TE/GE did not share this guidance with TAS until Jan. 7, 2014. As discussed below, TAS training for its employees on exempt organization procedures was recorded on Dec. 3, 2014; this new procedure could have been included in the training had TE/GE advised us that it was forthcoming.

17 See ABA Section of Taxation, *Comments of the Individual Members of the Exempt Organizations Committee's Task Force on Section 501(c)(4) and Politics* 44 (2004), available at <http://abanet.org/tax/pubpolicy/2004/040525exo.pdf>.

18 The ABA commenters noted that "Speaking at a conference in 1990, then Director of the IRS's Exempt Organizations Technical Division Marc Owens responded to a question about how much political activity a § 501(c)(4) organization could engage in by stating '[w]hen it comes to political activities, that is, giving money to a candidate, telling people to vote for a certain candidate, the rule is that it has to be less than primary. If it's 49 percent of their income, that is less than primary'" (emphasis added). ABA Section of Taxation, *Comments of the Individual Members of the Exempt Organizations Committee's Task Force on Section 501(c)(4) and Politics* n 82 (2004), available at <http://abanet.org/tax/pubpolicy/2004/040525exo.pdf>.

19 These rules are summarized as follows: "[B]usiness income arising from activities in furtherance of the organization's charitable purpose is never taxed, while the consequences of unrelated business income turns on whether the unrelated business activity is substantial: (1) If substantial, loss of exemption results (along with taxation of the income) or (2) if insubstantial, the income is subject to unrelated business income tax, but the tax exemption is not lost." Profs. Bishop and Kleinberger, *Exempt Organization Commercial Activity And Joint Ventures*, Limited Liability Companies: Tax and Business Law § 1.09 (Thomson Reuters Tax Accounting 2014).

20 Peter Molk, *Reforming Nonprofit Exemption Requirements*, 17 *Fordham J. Corp. & Fin. L.* 475, 491-492 (2012).

21 558 U.S. 310 (2010) (holding unconstitutional a statute banning corporate and union independent expenditures on express advocacy). According to the TIGTA report, the number of applications for exempt status under IRC § 501(c)(4) increased from 1,735 in FY 2010 to 3,357 in FY 2012. Moreover, "tax-exempt groups, such as I.R.C. § 501(c)(4), I.R.C. § 501(c)(5), and I.R.C. § 501(c)(6) organizations, spent \$133 million in Calendar Year 2010 on Federal candidate-oriented expenditures. In Calendar Year 2012, this figure increased to \$315 million." TIGTA report at 3.

22 Prop. Treas. Reg. § 1.501(c)(4)-1, 78 Fed. Reg. 71535 (Nov. 29, 2013), available at <http://www.regulations.gov/#!documentDetail;D=RS-2013-0038-0001>.

drafting process. Therefore, the National Taxpayer Advocate had no opportunity to influence the content of the proposed regulation prior to publication.

The proposed regulation would revise Treasury Regulation § 1.501(c)(4)-1(a)(2)(ii) to, among other things, provide that the promotion of social welfare does not include direct or indirect “candidate-related political activity.”<sup>23</sup> The proposed regulation does not posit a “bright line” ratio between social welfare and “candidate-related political activity,” but it borrows some of the other safe harbor concepts the IRS adopted in Letter 5228. For example, the proposed regulation provides that public communications made within 60 days of a general election (or within 30 days of a primary contest) that refer to one or more clearly identified candidates, or refer to one or more political parties represented in a general election, would be considered “candidate-related political activity.”<sup>24</sup> Volunteer activities, including public communications in the timeframe described above, are attributed to the organization, and could therefore count as “candidate-related political activity.”<sup>25</sup>

In some respects, the proposed regulation impedes more political activity than the IRS safe harbor because the regulation includes some nonpartisan activities in the definition of “candidate-related political activity.”<sup>26</sup> Examples are:

- Voter registration and get-out-the-vote drives;<sup>27</sup>
- Preparation or distribution of voter guides that refer to candidates (or to parties in a general election);<sup>28</sup> and
- Hosting events within 60 days of an election or within 30 days of a primary that one or more candidates attend as part of the program.<sup>29</sup>

The National Taxpayer Advocate finds the sweep of “candidate-related political activity” under the proposed regulation unacceptably broad. It appears that many others have views about the proposed regulations; 169,013 comments were received as of June 30, 2014.<sup>30</sup> On

23 The proposed regulations also requested public comments on the advisability of amending regulations under IRC § 501(c)(5) (labor, agricultural, or horticultural organizations), IRC 501(c)(6) (certain business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues organizations that promotes the common business interest), or political organizations exempt under IRC § 527 to provide that exempt purposes do not include “candidate-related political activity.”

24 Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii)(A)(2), 78 Fed. Reg. 71535 (Nov. 29, 2013), available at <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0001>.

25 *Id.* See also *Explanation of Provisions: Definition of Candidate-Related Political Activity. Public Communications Close in Time to an Election*, noting “In addition, the expansion of the types of communications covered in the proposed regulations reflects the fact that an organization’s tax exempt status is determined based on all of its activities, even low cost and volunteer activities, not just its large expenditures.”

26 The definition of “candidate-related political activity” is derived from Federal election campaign laws. See Federal Election Campaign Act (FECA) of 1971, 2 U.S.C. 431 (20); Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii) and *Explanation of Provisions: Definition of Candidate-Related Political Activity*.

27 Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii)(A)(5), 78 Fed. Reg. 71535 (Nov. 29, 2013), available at <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0001>.

28 *Id.*

29 Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii)(A)(8), 78 Fed. Reg. 71535 (Nov. 29, 2013), available at <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0001>.

30 See *Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* available at <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0001>.

May 22, 2014, the IRS announced that “[g]iven the diversity of views expressed and the volume of substantive input,” it would revise the proposed regulation before proceeding with a public hearing.<sup>31</sup>

Because the proposed guidance does not quantify the acceptable amount of political activity, it may be inadequate guidance for many organizations that are trying to abide by the law. The National Taxpayer Advocate would prefer an approach that not only establishes an acceptable level of activity that does not promote social welfare and does so with reference to the organization’s exempt social welfare activity, but that also takes into account the size and budget of the organization. As an alternative to the “candidate related political activity” test, the National Taxpayer Advocate recommends that Treasury and the IRS consider a rule similar to the IRC § 501(h) election applicable to 501(c)(3) organizations.

### *The IRC § 501(h) Expenditure Election and Lobbying Activities of IRC § 501(c)(3) Organizations*

In an effort “to set relatively specific expenditure limits to replace the uncertain standards of present law” (permitting section 501(c)(3) organizations to engage in only “insubstantial” lobbying activity), Congress in 1976 enacted IRC § 501(h).<sup>32</sup> This provision allows certain organizations to elect the use of a numerical test based solely on their expenditures (i.e., use of tax-exempt dollars) to determine whether they have engaged in excessive lobbying activities, thereby causing them to lose tax-exempt status under IRC § 501(c)(3).<sup>33</sup> To be clear, this numerical test is purely elective and thus operates as a “safe harbor.” Organizations that do not meet the numerical test or are uncertain may still apply through the regular EO application process.

Under the election, the amount of time an organization spends on an activity is not relevant except to the extent an expenditure (e.g., compensation) thereby arises. Volunteer activity is relevant to the determination only to the extent it triggers an expenditure. Section 501(h) limits are determined by reference to IRC § 4911, which imposes an excise tax on “excess lobbying expenditures.”<sup>34</sup> If the section 501(c)(3) organization’s lobbying expenditures do not exceed the IRC § 4911(c) limits, then the organization will not be taxed under section 4911 or lose its section 501(c) exemption.<sup>35</sup>

For electing organizations, permissible lobbying expenditures (not including grassroots expenditures) are calculated on a sliding scale expressed as a fixed dollar amount plus a

31 John Hicks, *IRS Postpones Hearing on Exempt-Group Rules*, The Washington Post, A-14 (May 23, 2014).

32 H.R. Rep. No. 94-1210, pt. 1, at 8 (1976); S. Rep. No. 94-938, pt. 2, at 80 (1976). For a discussion of the lengthy legislative history of the provision, described as representing “a compromise on a compromise on a compromise on a compromise” see Jill S. Manny, *Nonprofit Legislative Speech: Aligning Policy, Law, and Reality*, 62 Case W. Res. L. Rev. 757 (2012).

33 Tax Reform Act of 1976, Pub. L. No. 94-455, § 1307, 90 Stat. 1520, 1720 (1976).

34 IRC § 501(h)(2).

35 Treas. Reg. § 1.501(h)-1(a)(3).

percentage of the organization's "exempt purpose expenditure."<sup>36</sup> For example, under IRC § 4911, an organization with exempt purpose expenditures of more than \$500,000 but not over \$1 million could spend \$100,000 plus 15 percent of its exempt purpose expenditures over \$500,000 on lobbying activities.<sup>37</sup> An organization with exempt purpose expenditures of more than \$1 million but not over \$1.5 million could spend \$175,000 plus ten percent of its exempt purpose expenditures over \$1 million on lobbying activities.<sup>38</sup> However, the maximum amount of lobbying expenditures cannot exceed \$1 million for any organization, and "grassroots" expenditures must always be less than or equal to 25 percent of the permissible lobbying expenditure as calculated with the sliding scale.<sup>39</sup>

There is no provision available to organizations exempt under IRC § 501(c)(4) analogous to the election available to IRC § 501(c)(3) organizations under IRC § 501(h). The proposed Treasury regulations do not relate the amount of permissible political activity to another metric such as the organization's expenditures in furtherance of its exempt (social welfare) purpose. The National Taxpayer Advocate believes organizations requesting the right to receive contributions exempt from tax should be evaluated on how they expend those contributions. Under this analysis, as with the 501(h) election, volunteer time and activity, which do not generate taxable income for which tax exemption would be available in the first instance, are irrelevant to this determination (except to the extent an expenditure arises as a consequence of volunteer activity, *e.g.*, amounts spent to solicit and train volunteers or transport them to rallies or shopping malls where they campaign). Because it is unclear whether the IRS could adopt this approach by regulation, the National Taxpayer Advocate will make a legislative recommendation that incorporates these premises in her 2014 Annual Report to Congress.

**National Taxpayer Advocate Recommendation 2: *Consider legislation to provide applicants for exemption under IRC § 501(c)(4) with the ability to seek a declaratory judgment if denied or unanswered after nine months so that more judicial guidance can develop.***

As noted in the Special Report, an IRC § 501(c)(3) applicant may, upon exhaustion of administrative remedies, have judicial recourse to a declaratory judgment on exempt status if its application is denied or remains unanswered after about nine months (270 days).<sup>40</sup> Applicants for exempt status under IRC § 501(c)(4) do not have the same right to seek judicial review. Judicial review for section 501(c)(4) applicants would, among other things, provide for better guidance and transparency for IRS and taxpayers as to how this

36 IRC § 4911(c)(2). IRC § 4911(e)(1)(A) provides that "the term 'exempt purpose expenditures' means, with respect to any organization for any taxable year, the total of the amounts paid or incurred by such organization to accomplish purposes described in section 170(c)(2)(B) (relating to religious, charitable, educational, etc., purposes)." Under IRC § 4911(c) and (d) "grass root expenditure" means expenditures for the purpose of influencing legislation "through an attempt to affect the opinions of the general public or any segment thereof" (as opposed to "communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation").

37 IRC § 4911(c)(2).

38 *Id.*

39 *Id.*

40 See IRC § 7428.

tax exemption should be administered. The National Taxpayer Advocate has discussed this recommendation with congressional committee staff members, and the Chairman of the House Ways and Means Committee has released draft legislation that would create a right to declaratory judgment for section 501(c)(4) applicants.<sup>41</sup> We will continue to advocate for this important judicial remedy.

**National Taxpayer Advocate Recommendation 3:** *Explore the feasibility of requiring the FEC [Federal Election Commission] or another specialized agency to certify to the IRS that political activity proposed by an applicant for exemption under IRC § 501(c)(4) is not excessive.*

The IRS cites privacy rules as an impediment to sharing information between the two agencies, but notes that it does use information made publicly available by the FEC, among other sources, “in considering examination potential of referrals received or when reviewing operations of an organization under examination.”<sup>42</sup> As for having the FEC actually make a determination relating to an applicant’s proposed activities,<sup>43</sup> the IRS responds:

The IRS must determine whether an organization meets the requirements for exemption from tax, which may include making a determination of whether the organization is participating or intervening in a political campaign on behalf of or in opposition to a candidate for public office. This determination is based on all the facts and circumstances, and the scope of activity that will not further tax exempt purposes is not necessarily the same as the activity that is subject to regulation by the FEC. For example, participating or intervening in a political campaign on behalf of or in opposition to a candidate for public office includes activity at the state or local level, while the FEC only regulates federal election campaigns.<sup>44</sup>

It does not appear that the IRS has recently investigated the possibility of FEC certification or how obstacles to such certification could be overcome. However, the National Taxpayer Advocate is pleased the IRS still considers itself responsible for making a determination concerning the political activity of organizations applying under section 501(c)(4). As described below, TE/GE will essentially abdicate its responsibility to determine whether an organization is exempt under section 501(c)(3) - to the applicant itself.

41 See U.S. Congress, House Committee on Ways and Means, The Tax Reform Act of 2014, § 6002, 113 Cong., 2 sess., Feb. 2014, available at [http://waysandmeans.house.gov/uploadedfiles/statutory\\_text\\_tax\\_reform\\_act\\_of\\_2014\\_discussion\\_draft\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/statutory_text_tax_reform_act_of_2014_discussion_draft_022614.pdf).

42 TE/GE response to TAS information request (May 30, 2014), noting that a number of years ago, EO and the FEC “explored the possibility of sharing information about actions both agencies may be taking with respect to the same organizations. Due to the privacy rules applicable to the two agencies (the FEC may only make its investigations public when they are complete which is frequently after the statute of limitations for tax purposes has passed), it was determined that there was no useful method for sharing information.”

43 As noted above, the concept of “candidate-related political activity” in the proposed Treasury regulation is derived from federal election law. See Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii) and *Explanation of Provisions: Definition of Candidate-Related Political Activity*.

44 TE/GE response to TAS information request (May 30, 2014).



**National Taxpayer Advocate Recommendation 4: *Consider revising the IRC § 501(c)(4) application (Form 1024) to make further review unnecessary in most cases.***

The application form used to request exempt status under IRC § 501(c)(4), Form 1024 (*Application for Recognition of Exemption Under Section 501(a) or for Determination under Section 120*), asks simply if the organization plans to spend any money to influence the selection of any candidate.<sup>45</sup> Adding more detailed questions to Form 1024 could help the IRS make a determination about excessive political activity and could also help educate applicants about activity that could potentially disqualify them from being tax exempt. The IRS is not considering changes to Form 1024, in light of the safe harbor procedures, described above, for organizations whose applications indicate they could potentially be engaged in political activity.<sup>46</sup> The National Taxpayer Advocate is disappointed that TE/GE evidently intends to continue to rely on applicants' attestations that they meet the 60/40 safe harbor rather than revising Form 1024 to elicit information that would allow EO to determine whether there is or will be excessive political activity.

**National Taxpayer Advocate Recommendation 5: *Gather data from random audits and thereby develop a risk model to deploy in compliance reviews of organizations after operations have commenced.***

EO initially selects organizations for examination on the basis of referrals from outside sources and by analyzing data from Forms 990 to identify organizations engaging in possible impermissible campaign intervention.<sup>47</sup>

The EO Review of Operations (ROO) function then researches each case to determine whether to proceed with an examination, and its findings are reviewed by the Political Activity Referral Committee (PARC), which consists of three career civil service managers.<sup>48</sup> A cross-divisional team reviewed this process and "determined that, as implemented, the process promotes impartiality in the selection of organizations for examination."<sup>49</sup> EO notes that "Results of examinations will be used to determine the effectiveness of data analytics in case selection."<sup>50</sup> We interpret this to mean that EO agrees with the National Taxpayer Advocate's recommendation.

45 Question 15 on Form 1024 is: "Has the organization spent or does it plan to spend any money attempting to influence the selection, nomination, election, or appointment of any person to any Federal, state, or local public office or to an office in a political organization?"

46 TE/GE response to TAS information request (May 30, 2014).

47 *Id.*

48 *Id.*

49 *Id.*

50 *Id.*

**National Taxpayer Advocate Recommendation 6: *Publish on the Internet objective criteria that may trigger additional review of applications for exemption and the procedures IRS specialists use to process applications involving political campaign activity.***

On September 30, 2013, TE/GE issued interim guidance directing employees to route applications involving political activity to a specialty group within the division.<sup>51</sup> Interim guidance issued on December 10, 2013, outlines procedures for sending additional information request letters to IRC § 501(c)(3) applicants with certain types of potential political activities.<sup>52</sup> The guidance, while publicly available, is not readily accessible. A search of IRS.gov using terms “501(c)(3) political activity” or “501(c)(3) potential political activity” or “501(c)(3) political guidance” does not reference or link to it. Even searching for the control number of the guidance (TEGE-07-1213-23) on IRS.gov does not produce it. Taxpayers using a generic Internet search engine can locate the guidance if they search for it by control number, but a taxpayer would not be able to find this guidance without knowing that cite. The IRS should make this guidance more easily accessible to the public, including exempt organizations.

As noted above, IRC § 501(c)(3) prohibits any participation or intervention in political campaigns on behalf of candidates for public office. The guidance notes:

The following types of activities may suggest the potential for political campaign intervention (see also IRM 7.20.5, *Review Procedures for EO Determinations*):

- Voter registration
- Inaugural and convention host committees
- Post-election transition teams
- Voter guides
- Voter polling
- Voter education
- GOTV [get out the vote] drives
- Events at which candidates speak
- Communications expressing approval or disapproval of candidates’ positions or actions
- Other activities that appear to support or oppose candidates for public office

51 See Interim Guidance, TEGE-07-0913-15, *Interim Guidance on Initial Classification of Applications* (Sept. 30, 2013) available at [http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0913-15\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0913-15[1].pdf). “Political/Advocacy” applications indicating “Actual or potential political campaign intervention,” “Lobbying activity that exceeds permitted thresholds,” or “Benefits to a political party or a candidate for public office” were to be routed to a specialized group for secondary screening.

52 See Interim Guidance, TEGE-07-1213-23, *Processing Guidelines for Section 501(c)(3) Applications Involving Potential Political Campaign Intervention* (Dec. 10, 2013) available at [http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-23\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-23[1].pdf).

Sample questions that might be asked of these section 501(c)(3) applicants are publicly available on IRS.gov.<sup>53</sup>

As discussed above, TE/GE adopted and notified applicants under section 501(c)(4) of the new “safe harbor” provisions where the applications “indicate the organization may be involved in political campaign intervention or issue advocacy.”<sup>54</sup> The “safe harbor” guidance does not set out what the “indications” may consist of. However, Internal Revenue Manual (IRM) guidance (referenced in the guidance pertaining to 501(c)(3) applicants) does not distinguish between organizations applying under section 501(c)(3) and those applying under section 501(c)(4) in this respect.<sup>55</sup> Sample questions that might be asked of section 501(c)(4) applicants are also publicly available on IRS.gov.<sup>56</sup>

**National Taxpayer Advocate Recommendation 7: *The IRS Commissioner should require all IRS functions to clear all guidance and procedures that affect taxpayer rights in any way with TAS and incorporate it into the public IRM (or clear it with internal stakeholders, including TAS, and then post it to the Internet in the same manner as the IRM).***

The National Taxpayer Advocate has repeatedly urged the IRS to share IRM provisions and other guidance affecting taxpayer rights with TAS for review and comment prior to issuance.<sup>57</sup> TE/GE, however, has published several important pieces of guidance without any consultation with TAS. The proposed regulation, discussed above, is one example. The guidance extending the “safe harbor” option to all organizations seeking exemption under section 501(c)(4) is another. Making available to the public, on March 31, a new draft Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* discussed below, is yet a third. These oversights have occurred despite monthly meetings between TE/GE and TAS senior leadership and staff that began in June of 2013. We believe that TE/GE’s continuing insistence on implementing procedures and notices without consultations with TAS is unacceptable, uncollaborative, and in violation of the stated congressional purpose of TAS. We expect a change.

53 See *Applying for Exemption/Misc. Determination: Sample Questions: Attempting to Influence Legislation or Political Campaign Intervention Activities*, available at <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exempt-Organization-Sample-Questions-Attempting-to-Influence-Legislation-or-Political-Campaign-Intervention-Activities>. The first question, which follows an explanation of the difference between a section 501(c)(3) organization and a section 501(c)(4) organization is “State whether or not you would like us to consider you as an organization described under Section 501(c)(4) as a social welfare organization rather than as a Section 501(c)(3) organization.”

54 Tax Analyst Tax Notes Today, 2013 TNT 129-15 *IRS Provides Instructions For Optional Expedited Process For Some Tax-Exempt Applications* (July 5, 2013).

55 See IRM 7.20.5.4, Cases Subject to Review (Mar. 7, 2008) par. (3)(x) providing for mandatory review of “[a]pplications that present sensitive political issues, including the following types of activities: Voter registration; Inaugural and convention host committees; Post-election transition teams (to assist the elected official prior to officially assuming the elected position); Voter guides; Voter polling; Voter education; Other activities that may appear to support or oppose candidates for public office.”

56 See *Applying for Exemption/Misc. Determination: Sample Questions: Attempting to Influence Legislation or Political Campaign Intervention Activities*, available at <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exempt-Organization-Sample-Questions-Attempting-to-Influence-Legislation-or-Political-Campaign-Intervention-Activities>.

57 See, e.g., National Taxpayer Advocate’s Report in Response to the Acting Commissioner’s 30 Day Report, *Analysis and Recommendations to Raise Taxpayer and Employee Awareness of the Taxpayer Advocate Service and Taxpayer Rights* (Aug. 19, 2013), available at <http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/30-Day-Report.pdf>. See also Area of Focus: Guidance Clearance Process, below, describing the lack of currency of many IRM provisions and the use of interim guidance.

The National Taxpayer Advocate has raised concerns about TE/GE's pattern of ignoring TAS as a participant in the internal comment cycle, or giving TAS insufficient time to comment prior to publication, to both the TE/GE Commissioner and the Commissioner of Internal Revenue. Both have committed to ensure that TE/GE improves in this regard, and as discussed below, TE/GE recently shared draft interim guidance conferring administrative appeal rights, which has now been issued.<sup>58</sup>

**National Taxpayer Advocate Recommendation 8: *Implement the National Taxpayer Advocate's recommendation to create a Taxpayer Bill of Rights.***

As discussed in the Special Report, according to TIGTA EO did not always operate in accordance with the rights articulated in the Taxpayer Bill of Rights (TBOR).<sup>59</sup> Thus, in the Special Report, the National Taxpayer Advocate recommended the adoption of TBOR as a means of improving handling of EO cases, among other things. She found that based on TIGTA's description of IRS actions with respect to 501(c)(4) organizations, the IRS violated at least eight of the ten taxpayer rights proposed by the National Taxpayer Advocate.<sup>60</sup>

As discussed below, on June 10, 2014, the IRS adopted a TBOR and has incorporated it into Publication 1, *Your Rights as a Taxpayer*.<sup>61</sup> In FY 2015, TAS will work to educate taxpayers and IRS employees, including EO employees, about the TBOR and to embed the TBOR into IRS practices and procedures.

**National Taxpayer Advocate Recommendation 9: *Authorize the National Taxpayer Advocate to make an "apology" payment of up to \$1,000 to a taxpayer where the action or inaction of the IRS caused excessive expense or undue burden, and the taxpayer experienced a "significant hardship."***

The National Taxpayer Advocate recommended that Congress authorize apology payments. If enacted, an organization could seek an apology payment if EO violated the taxpayer's rights, such as when EO delayed taking action on an application for recognition of exempt status.<sup>62</sup> The National Taxpayer Advocate is not aware of any steps that Congress has taken to implement this recommendation since the issuance of last year's Special Report.<sup>63</sup>

58 Interim Guidance, TE/GE-07-0514-0012 (May 19, 2014), available at [http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0514-0012\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0514-0012[1].pdf). The National Taxpayer Advocate has also recommended that the IRS allow administrative review of automatic revocations of tax exempt status. See National Taxpayer Advocate 2011 Annual Report to Congress 562, Legislative Recommendation: *Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*.

59 Special Report at vii.

60 Special Report vii-viii.

61 See Area of Focus: Taxpayer Rights, *supra*; *IRS Adopts Taxpayer Bill of Rights*. <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>; William Hoffman, Koskinen and Olson Unveil IRS's New Taxpayer Bill of Rights 2014 TNT 112-2 (June 10, 2014) (noting the Commissioner's commitment to include TBOR in Pub. 1, *Your Rights as a Taxpayer*, which reaches about 30 million taxpayers each year); Pub. 1 (rev. June 2014) available at <http://www.irs.gov/pub/irs-pdf/p1.pdf>.

62 Special Report at 5.

63 The National Taxpayer Advocate initially recommended that Congress authorize the IRS to make symbolic apology payments in her 2007 report for reasons unrelated to problems with TE/GE. See National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payment*). The proposal was included in The TAX GAP Act, S. 1289, 112th Cong. § 107 (2011).

**National Taxpayer Advocate Recommendation 10:** *Reinstate the annual joint oversight hearings held after RRA 98 to help identify and address problem areas, with specific focus on how the IRS is meeting the needs of particular taxpayer segments, including individuals, small businesses, and exempt organizations.*

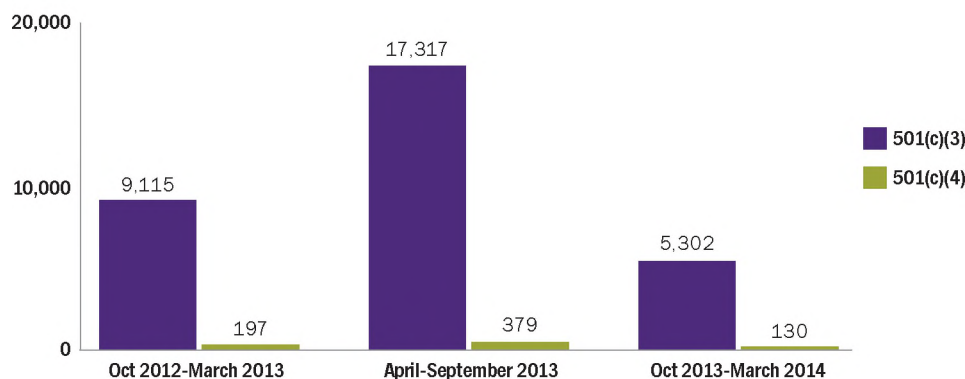
The National Taxpayer Advocate is not aware of any steps Congress has taken to implement this recommendation.

**National Taxpayer Advocate Recommendation 11:** *EO should track the age and cycle time of all of its cases, including those referred to EO Technical, so that it can detect backlogs early in the process and conduct periodic reviews of over-aged cases to identify the cause of the delays.*

EO uses the Exempt Determination System, its system of record, to track inventory, and provided data about its determinations inventory over the past two years.<sup>64</sup>

As Figure II.5 shows, from FY 2013 to the first half of FY 2014, EO closed many of its cases by approving the applications, without any contact with the taxpayer.<sup>65</sup> It closed many more applications under section 501(c)(3) than under section 501(c)(4).

**FIGURE II.5, EXEMPT ORGANIZATION APPLICATIONS APPROVED WITH NO CONTACT**



Average cycle time for all approved applications actually increased from the first half of FY 2013 to the first half of FY 2014, from 195 to 315 days or 62 percent.<sup>66</sup> The cycle time of applications approved with no contact with the taxpayer or with accelerated procedures rose at an even greater rate, climbing from 160 days in the first half of FY 2013 to 298 days in the first half of FY 2014, an increase of 86 percent. The number of over-age cases (in

64 TE/GE response to TAS information request (May 30, 2014).

65 EO approved 3,764; 7,471; and 3,219 applications in the first half of FY 2013, the second half of FY 2013, and the first half of FY 2014, respectively. EO approved, without any contact with the taxpayer, an additional 9,115; 17,317; and 5,302 cases in the same respective periods, and an additional 7,282; 12,852; and 9,706 cases using streamlined procedures in the same respective periods. It disapproved 41; 72; and 41 applications in the same respective periods.

66 Cycle time is the number of days that elapse between the date the application was received and the date it was closed. IRM 7.22.7.3 (Jan. 1, 2003).

which the application had been outstanding for more than 270 days) that were ultimately approved, however, began at 7,701 in the first half of FY 2013, peaked at 15,963 in the second half of FY 2013, and declined to 10,978 in the first half of FY 2014.<sup>67</sup>

This data is consistent with EO's approach of working its older inventory first. While this approach is appropriate, cycle times remain unacceptably high. The TE/GE Commissioner announced a goal of having year-end inventory with no applications under section 501(c)(3) that have been pending for more than nine months. The ultimate goal is to process all applications within six months.<sup>68</sup> The National Taxpayer Advocate finds these goals admirable and has heard them announced in earlier years, but as described below, she now has serious concerns about how EO intends to accomplish them.<sup>69</sup>

**National Taxpayer Advocate Recommendation 12:** *EO should track requests for guidance or assistance from the EO Technical Unit so that management can assess the timeliness and quality of the guidance and assistance it provides to both Determinations Unit employees and the public.*

In interim guidance issued on July 15, 2013, TE/GE advised EO Determinations employees how to request technical assistance from EO Technical. According to the guidance:

Technical assistance may involve any tax matter or emerging technical issue(s) and is requested when:

- a. A potential problem is recognized from a newspaper or magazine article.
- b. A relevant state or local law or ordinance was recently enacted.
- c. Uncertainty exists regarding the interpretation of internal revenue laws, related statutes and regulations, published revenue rulings, revenue procedures, or any other published precedent.<sup>70</sup>

The interim guidance imposes timeframes for responding to requests for technical assistance and provides for tracking of the requests. EO established a dedicated email account for EO Determinations employees to submit technical assistance requests to EO Technical.<sup>71</sup> These requests, which management is expected to expedite, are logged and monitored to ensure they are completed within 30 to 120 days, and are subject to monthly mandatory

67 For applications that were ultimately disapproved, average cycle time also increased, going from 793 days in the first half of FY 2013 to 1,039 days in the first half of FY 2014 an increase of 31 percent. The number of over-age cases that were ultimately disapproved went from 41 in the first half of FY 2013 to 70 in the second half of FY 2013, then back to 41 for the first half of FY 2014.

68 Jeff Carlson, *IRS Making Progress in Improving 501(c)(3) Application Process, Says Koskinen*, CCH News (April 8, 2014), reporting on Commissioner Koskinen's testimony before the House Appropriations Committee Subcommittee on Financial Services and General Government on the fiscal year 2015 IRS budget.

69 See, e.g., IRS response, National Taxpayer Advocate 2012 Annual Report to Congress 202-203 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process are Burdening Tax-Exempt Organizations*); IRS response, National Taxpayer Advocate 2007 Annual Report to Congress 217 (Most Serious Problem: *Determination Letter Process*).

70 See Interim Guidance, TEGE-07-0713-11, *Interim Guidance on Requests for Technical Assistance* (July 15, 2013).

71 TE/GE response to TAS information request (May 30, 2014).

reviews.<sup>72</sup> Since the July 15, 2013, guidance was issued, EO Technical received two requests, both of which it answered and closed expeditiously.<sup>73</sup>

In interim guidance issued on September 30, 2013, TE/GE advised employees that it had formed a new EO Emerging Issues Committee (EIC) “as part of our efforts to ensure that potential issues needing coordination are properly handled, decisions documented, and employees provided sufficient guidance, procedures, and training to perform their duties.”<sup>74</sup> The guidance includes the new committee’s charter, a detailed flowchart explaining its processes and timeframes, and a form to refer issues to the committee. The EIC tracks the receipt and disposition of elevated issues and communicates the disposition to the originating employee.<sup>75</sup> It has received eight elevated issues, all in the first half of FY 2014,<sup>76</sup> and has vetted and completed review of four.<sup>77</sup> Of the remaining four issues, three are under review, and one could be resolved by current internal processes.<sup>78</sup>

With respect to individual applications for status under section 501(c)(4), in interim guidance issued on December 23, 2013, TE/GE instructed employees how to handle cases in which an organization received Letter 5228, *Application Notification of Expedited 501(c)(4) Option*, discussed above, but did not respond with the required certifications within 45 days.<sup>79</sup> Those applications would be sent for further review to EO Technical, which could request additional information from the organization. If the unit recommended an adverse determination, Chief Counsel attorneys would review the application. If Chief Counsel did not agree with the EO Technical recommendation, the application would be further reviewed by the newly-formed Advocacy Application Review Committee, comprised of the Director, EO; Commissioner (TE/GE); and Division Counsel/Associate Chief Counsel (TE/GE), or their delegates. As described below, these procedures have been supplanted by normal administrative appeal procedures.<sup>80</sup>

**National Taxpayer Advocate Recommendation 13: *The IRS should create an administrative appeal process for organizations whose exempt status was automatically revoked in error.***

The National Taxpayer Advocate recommended in her 2013 Annual Report to Congress that the IRS:

72 TE/GE response to TAS information request (May 30, 2014).

73 *Id.*

74 See Interim Guidance, TEGE-07-0913-17, *The EO Emerging Issue Committee* (Sept. 30, 2013), available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0913-17%5b1%5d.pdf>.

75 TE/GE response to TAS information request (May 30, 2014).

76 *Id.*

77 Of these four issues, “two pertained to procedural items associated with application case work and not particular to technical case law. The remaining two issues pertained to established tax law and resolution was provided back to the originator.” TE/GE response to TAS information request (May 30, 2014).

78 “A reminder of that existing process was provided to the originator of the issue.” TE/GE response to TAS information request (May 30, 2014).

79 See Interim Guidance, TEGE-07-1213-24, *Request for EO Technical Assistance* (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5B1%5D.pdf>.

80 Interim Guidance, TEGE-07-0514-0012 (May 19, 2014) available at [http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0514-0012\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0514-0012[1].pdf).

[i]ssue a letter informing the organization when the IRS proposes to treat it as having had its exempt status automatically revoked and providing an opportunity to correct the condition that caused the proposed automatic revocation within 30 days. The letter should specify the availability of administrative review for organizations raising concerns that the IRS is proceeding in error.<sup>81</sup>

The IRS responded to this recommendation by noting that when it notifies organizations that they did not file a return, it also advises them of the consequences of failing to file for three consecutive years, and that “the effectiveness of yet another letter thirty days before automatic revocation would be unclear.”<sup>82</sup> Moreover, according to the IRS,

The statute does not provide for administrative review of automatic revocation. Once an organization has failed to file the third required return, it is revoked by operation of law. In addition to its existing efforts, the IRS will consider further steps to advise organizations of their filing obligation, particularly by reviewing the content of Notice 259A and Notice CP 575E (“We assigned you an Employer Identification Number”), which is generally received at inception, and revising them as appropriate.<sup>83</sup>

The National Taxpayer Advocate urged the IRS to reconsider its position, noting that administrative review is not prohibited by statute, and that even if exempt status is revoked by operation of law, nothing requires the IRS to immediately remove the organization from the list of those eligible to receive deductible contributions (which could be fatal to the organization).<sup>84</sup> She noted that the IRS already adjusts its records, and the list the public relies on, after it erroneously lists organizations as no longer exempt, a procedure that takes time. Sound tax administration would allow organizations to show the IRS is in error beforehand, and would minimize damage and rework.<sup>85</sup>

The IRS has not changed its response to the recommendation. However, as noted above, on June 9, 2014, the IRS adopted the Taxpayer Bill of Rights (TBOR), which includes “administrative appeal of most IRS decisions ...”<sup>86</sup> These positions seem inconsistent. Thus, in accordance with TBOR principles, in FY 2015, the National Taxpayer Advocate will continue to advocate that the IRS provide organizations with an opportunity to disagree with the automatic exemption before removing them from the public list of exempt organizations. She will also recommend a legislative change in her 2014 Annual Report to Congress.

81 National Taxpayer Advocate 2013 Annual Report to Congress 165, 172, Most Serious Problem: *EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*.

82 IRS Response to recommendation 15-1, National Taxpayer Advocate 2013 Annual Report to Congress 165, 172, Most Serious Problem: *EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*.

83 IRS Response to recommendation 15-1, National Taxpayer Advocate 2013 Annual Report to Congress 165, 172, Most Serious Problem: *EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status* (May 23, 2014), available at [taxpayeradvocate.irs.gov/userfiles/file/IRS-2013-MSP-Responses.pdf](http://taxpayeradvocate.irs.gov/userfiles/file/IRS-2013-MSP-Responses.pdf).

84 June 2, 2014 comment from the National Taxpayer Advocate to IRS operating divisions on their responses to the 2013 Annual Report to Congress recommendations.

85 *Id.*

86 See *IRS adopts Taxpayer Bill of Rights*, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>.



**National Taxpayer Advocate Recommendation 14:** *The National Taxpayer Advocate should provide training to EO employees about her authority under IRC § 7811 to order expedited processing of applications for exempt status and advocate for taxpayers.*

As described in the National Taxpayer Advocate’s 2013 Special Report, the TE/GE Director of Exempt Organizations had for years maintained that the “expedite” criteria specific to EO determinations cases, found in the IRM and other IRS guidance, governed TAS EO cases.<sup>87</sup> The National Taxpayer Advocate maintained that TAS’s statutory authority to direct the IRS to act where a taxpayer is experiencing a significant hardship applied to EO cases, regardless of EO’s “expedite” criteria. The attitude that EO did not have to be responsive to TAS permeated the organization. In two two-hour face-to-face meetings with managers and employees in the EO Determinations Unit on August 7, 2013, the National Taxpayer Advocate explained the Office of the Taxpayer Advocate’s statutory authority under IRC § 7811 and the role of TAS in EO cases. By the end of August 2013, under instructions from newly-appointed EO leadership, the unit’s employees no longer insisted on applying only EO expedite criteria and routinely accepted TAS requests for expedited processing where TAS determined that the taxpayer was suffering or about to suffer a significant hardship within the meaning of IRC § 7811.<sup>88</sup>

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**We have encountered resistance from EO leadership and employees in ways that demonstrate they still do not understand TAS’s role.**

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On June 26, 2014, the National Taxpayer Advocate recorded additional training for TE/GE employees on TAS’s role and TAS procedures, which is expected to be delivered in July of 2014. In the meantime, we have encountered resistance from EO leadership and employees in ways that demonstrate they still do not understand TAS’s role. In addition to overlooking TAS’s role in reviewing proposed guidance that affects taxpayer rights, EO has refused to share information in its files with TAS, claiming it is “nondisclosable.”<sup>89</sup> EO initially declined to allow TAS employees access to a database that would allow TAS to advocate more effectively for taxpayers.<sup>90</sup>

87 National Taxpayer Advocate’s Special Report at 28.

88 Email from Acting Director, EO Rulings and Agreements, to front-line managers (Aug. 13, 2013).

89 For example, EO employees sometimes prepare check sheets, which are similar to inventories of information the organization has submitted, to assist in evaluating applications for exempt status. TAS learned of the check sheets when the National Taxpayer Advocate met with EO managers and employees in August of 2013. She noted that case advocates, by consulting a check sheet, could more easily identify missing or insufficient information in an application for exempt status and could assist the taxpayer in obtaining additional documents. EO assisted TAS in including a discussion of the check sheets in TAS’s December 2013 training for TAS employees, discussed below, and provided the check sheets for inclusion in TAS’s written training materials. When case advocates, after taking the training, began requesting the check sheets, EO employees refused to provide them, citing “problems” with “disclosure.”

90 TE/GE databases, such as TEDS (for Tax Exempt Determination System) may contain the organization’s application for exempt status, or supporting documents, such as the organization’s articles of incorporation. Review of these materials may assist a TAS case advocate in determining whether the application appears sufficient, or whether a required document or provision in a document is lacking, and to work with the taxpayer to rectify any error. The National Taxpayer Advocate has since obtained a commitment from the Commissioner of TE/GE to provide licenses to ten TAS employees in various geographic locations to access TEDS, but this access has yet to be implemented.

**National Taxpayer Advocate Recommendation 15:** *TAS and the National Taxpayer Advocate should provide guidance and training to EO employees about when to refer cases to TAS.*

The National Taxpayer Advocate's June 26 training included examples of the types of cases and requests TE/GE (primarily EO employees, who handle applications for recognition of exempt status) would receive from TAS. The training also instructed TE/GE employees about how and when to refer cases to TAS, and clarified their obligation to share information in IRS files with TAS employees who have a business reason to review it.

**National Taxpayer Advocate Recommendation 16:** *TAS and the National Taxpayer Advocate should provide guidance and training to EO employees about when to refer systemic issues to TAS.*

The National Taxpayer Advocate's training for TE/GE employees also included instruction on how to identify systemic issues and record them on TAS's tracking system, Systemic Advocacy Management System (SAMS).

## New Developments

***The National Taxpayer Advocate Provided Training to TAS Employees, But EO Substantially Changed its Procedures***

In December 2013, the National Taxpayer Advocate and her staff developed courses that TAS employees were required to complete by March 14, 2014.<sup>91</sup> Notwithstanding our best efforts and communications with EO, however, EO changed whole elements of its procedures within weeks after the TAS training. The first portion of the training consists of written materials and a video in which TAS Attorney Advisors explain the rules for obtaining exempt status under IRC § 501(c)(3) and (c)(4). The training, based on materials EO uses to train its own employees, clarifies matters such as why an EO employee needs certain documentation from the taxpayer, such as articles of incorporation or other organizational documents, in order to make a determination. The second portion of the training consists of written materials and another video in which the National Taxpayer Advocate discusses the issues that most frequently arise in TAS cases involving exempt organizations.<sup>92</sup> The training instructs employees how to advocate for taxpayers in light of EO's processes and procedures. At TAS's request, EO advised TAS of items it believes would be helpful to include in the training, and the National Taxpayer Advocate incorporated those suggestions into her presentation.

EO's procedures changed shortly after TAS taped its training. For example, EO no longer prepared the same checksheets that helped identify elements of an application, such as

91 The National Taxpayer Advocate has steadfastly committed to provide this training. National Taxpayer Advocate Special Report 28-34; National Taxpayer Advocate's Report in Response to the Acting Commissioner's 30 Day Report, *Analysis and Recommendations to Raise Taxpayer and Employee Awareness of the Taxpayer Advocate Service and Taxpayer Rights* at 3 (Aug. 19, 2013).

92 The two videos were recorded on DVDs, designated as C01 and C02, and accompanying written training materials were prepared, designated with course numbers of 55250-102 (student guide) and 55250-103 (facilitator guide).

articles of incorporation, that were missing or insufficient.<sup>93</sup> As described below, even more drastic was EO's shift to a streamlined application process, previously reserved for existing inventory, for new applications.

### *EO Adopted Streamlined Procedures for Reducing Existing Inventory*

In addition to attending to its inventory of applications for exempt status under section 501(c)(4), EO adopted streamlined procedures for managing its backlog of 501(c)(3) applications.<sup>94</sup> The streamlined procedures, which initially applied only to cases more than a year old, allowed certain aspects of the application to be “developed through attestation” rather than substantiating documents.<sup>95</sup> For example, if the organization did not submit an organizing document with its application, or if the document was not a filed or conformed copy, then the organization would be asked to attest that it had an “appropriate organizing document,” and to give the date the organizing document was filed (in the case of a corporation) or adopted (in the case of an association or trust). The organization would also be asked to attest that its organizing document meets statutory and regulatory requirements or had been amended to meet these requirements.<sup>96</sup> If the organizing document appeared to be insufficient, the organization would be directed to amend it to include the appropriate provisions and attest that the necessary amendments had been made.

If the IRS needed clarification regarding the activities of the organization (*e.g.*, because the organization did not include a narrative statement of its activities as required by Form 1023 or because the statement was simply a mission statement or did not provide sufficient detail to evaluate it), then it asked the organization to attest that it met the operational test for exempt status.<sup>97</sup> If there was clear evidence of an issue that would cause the organization to be denied exemption under the organizational test, this option of attestation was not available, and the application was evaluated under normal (non-streamlined) procedures.

93 Moreover, as described above, EO refused to provide checksheets it had already prepared, citing “disclosure” concerns.

94 See *Danny Werfel Updates AICPA on IRS Accomplishments* (Nov. 5, 2013), describing the IRS's use of Lean Six Sigma methodology as a means of reducing inventory backlog, available at <http://irweb.irs.gov/AboutIRS/co/news/38749.aspx>.

95 On Dec. 9, 2013, EO provided TAS with a detailed description of the streamlined process. See SAMS 28975. In a Jan. 26, 2014, memorandum from the Acting Director, Exempt Organizations, *Streamlined Processing Guidelines for Cases Over One Year Old*, EO adopted the streamlined procedures for inventory over a year old as of Oct. 1, 2013.

96 IRS Letter 1312, *Request for Additional Information*, would advise that “Section 1.501(c)(3)-1(b) of the Treasury Regulations describes the requirements an organizing document must meet in order for an organization to be organized for one or more exempt purposes under section 501(c)(3). The organizing document must: (a) Limit the purposes of such organization to one or more exempt purposes under IRC 501(c)(3); and (b) not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes; and (c) provide that an organization's assets must be dedicated to an exempt purpose within IRC 501(c)(3), either by an express provision in its governing instrument or by operation of law.”

97 IRS Letter 1312, *Request for Additional Information*, would advise “It is not evident from the information you submitted whether or not you meet the operational requirements to be exempt under section 501(c)(3). Therefore, please sign below to attest that you are operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”

In February of 2014, EO extended the streamlined procedures for processing applications under section 501(c)(3) to all existing inventory (*i.e.*, not only to applications that were more than a year old).<sup>98</sup>

### *EO Will Now Extend Streamlined Processing to New Applications Through a New Form 1023-EZ*

In her 2011 Annual Report to Congress, the National Taxpayer Advocate recommended that the IRS develop a Form 1023-EZ for use by small organizations.<sup>99</sup> It was her position that a Form 1023-EZ could be designed to elicit relevant information without imposing undue burden on exempt organizations.<sup>100</sup> The IRS responded that it did “not believe that a less comprehensive application satisfies Congress’ intent in requiring automatically revoked organizations to apply to the IRS for recognition of exemption.” Rather, the IRS said it believed “its obligation to decide whether an organization qualifies for exemption, by itself, justifies the extent of information requested on the Form 1023.” Moreover, “the Form 1023 also serves an educational purpose because it provides applicants either an introductory or a refresher course on the rules for tax exemption. Finally, the law encourages transparency and accountability to the public by requiring organizations to make their Form 1023 exemption applications and their Form 990-series information returns available to the public.”<sup>101</sup>

Despite these previous demurrals, on March 31, 2014, the IRS made available to the public, without first consulting with the National Taxpayer Advocate, a proposed draft of IRS Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.<sup>102</sup> The form adopts the same “streamlined” approach described above: organizations with a specified level of annual gross receipts, which we understand will be \$50,000 or less, will not be required to furnish any documents in support of their claim that they are tax exempt. They will merely attest that they meet the requirements for

98 Memorandum from the Acting Director, *Exempt Organizations Streamlined Processing Guidelines for All Cases* (Feb. 28, 2014).

99 National Taxpayer Advocate 2011 Annual Report to Congress 437 (Status Update: *The IRS Makes Reinstatement of an Organization’s Exempt Status Following Revocation Unnecessarily Burdensome*), 562 (Legislative Recommendation: *Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*).

100 For example, question 11 of Part VII could be described as “mindnumbing” and likely inapplicable to small organizations. That question is: “Do you or will you accept contributions of: real property; conservation easements; closely held securities; intellectual property such as patents, trademarks, and copyrights; works of music or art; licenses; royalties; automobiles, boats, planes, or other vehicles; or collectibles of any type? If ‘Yes,’ describe each type of contribution, any conditions imposed by the donor on the contribution, and any agreements with the donor regarding the contribution.” Another example is in Part V, question 1b: “List the names, titles, and mailing addresses of each of your five highest compensated employees who receive or will receive compensation of more than \$50,000 per year.” A Form 1023-EZ could simply ask if any employees received more than \$50,000 per year in compensation from the organization. If the answer is “yes”, then the EO could be required to file the full Form 1023.

101 IRS Response, National Taxpayer Advocate 2011 Annual Report to Congress 437 at 445-446 (Status Update: *The IRS Makes Reinstatement of an Organization’s Exempt Status Following Revocation Unnecessarily Burdensome*).

102 The IRS notified the public it was developing a Form 1023-EZ and requested comment. Submission for OMB Review; Comment Request, 79 Fed. Reg. 18124 (Mar. 31, 2014), available at <https://www.federalregister.gov/articles/2014/03/31/2014-07066/submission-for-omb-review-comment-request>. The notice did not contain the draft Form 1023-EZ, but a copy of a Feb. 19, 2014, version of the form was available at [www.reginfo.gov/public/do/DownloadDocument?documentID=454039&version=0](http://www.reginfo.gov/public/do/DownloadDocument?documentID=454039&version=0).

tax exemption.<sup>103</sup> Form 1023-EZ does not even provide a space for, much less require, a narrative description of the organization's proposed activities.

On May 5, 2014, TAS raised its concerns in comments on the draft form through internal review procedures. The National Taxpayer Advocate also had extensive conversations with the Commissioner and raised her concerns in additional conversations with officials in the Treasury's Office of Tax Policy. On May 19, 2014, the IRS Office of Chief Counsel included the National Taxpayer Advocate in its circulation of proposed regulations that would amend current regulations to allow certain applicants for recognition of exempt status under IRC § 501(c)(3) to apply using Form 1023-EZ. On May 29, 2014, the IRS Office of Chief Counsel included the National Taxpayer Advocate in its circulation of a proposed revenue procedure implementing Form 1023-EZ.

On May 27, 2014, the National Taxpayer Advocate sent a memorandum to the Chief Counsel, the Commissioner of TE/GE and the Assistant Secretary (Tax Policy) of the Department of the Treasury, with a copy to the IRS Commissioner, outlining her concerns with the draft form.<sup>104</sup> The memorandum is attached to this report.

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**The IRS, by granting near-automatic exempt status to organizations anticipating less than \$50,000 in annual receipts, which, according to TE/GE, constitute a significant majority of new EOs, evidently believes these organizations pose low risks to compliance simply by virtue of their limited size, an assumption not based on any reliable empirical data.**

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The National Taxpayer Advocate continues to be deeply concerned about the IRS's abdication of its responsibility to *determine* whether an organization is organized and operated for an exempt purpose and not merely accept an organization's statement to that effect. By adopting this approach, the IRS will undo, in the space of less than six months, decades of practice in this area. Moreover, it appears the IRS intends to implement Form 1023-EZ by issuing temporary regulations and a revenue procedure for which it never sought public comment.<sup>105</sup> The National Taxpayer Advocate submitted her formal comments to the draft implementing materials on June 9, 2014.<sup>106</sup> In her comments, the National Taxpayer Advocate noted that:

- The IRS, by granting near-automatic exempt status to organizations anticipating less than \$50,000 in annual receipts, which, according to TE/GE, constitute a significant majority of new EOs, evidently believes these organizations pose low risks to compli-

103 As of the date of this report, the most recent version of Form 1023-EZ available on IRS.gov is a draft version dated April 23, 2014, available at <http://www.irs.gov/pub/irs-dft/f1023ez--dft.pdf>. There are no draft instructions for the form available on IRS.gov, but a Feb. 2, 2014 version of the instructions is available at <http://www.bing.com/search?q=instructions+form+1023-ez&src=IE-SearchBox&Form=IE8SRC>. The draft instructions reference a level of gross receipts of \$200,000 and assets of \$500,000; our understanding is that the gross receipts eligibility ceiling will actually be \$50,000.

104 Memorandum from the National Taxpayer Advocate to IRS Chief Counsel, the Commissioner of TE/GE and the Assistant Secretary (Tax Policy), of the Department of the Treasury (May 27, 2014).

105 Additionally, on June 25, 2014, TE/GE shared with TAS draft interim guidance on processing Form 1023-EZ. See SAMS 30656.

106 Memorandum from National Taxpayer Advocate to IRS and Treasury officials, *Comment on Proposed Changes to Exempt Organization Application Procedures* (June 9, 2014).

ance simply by virtue of their limited size, an assumption not based on any reliable empirical data;

- The IRS’s ability to monitor compliance after an organization obtains its exemption approval will be limited because organizations with receipts of less than \$50,000 have minimal reporting obligations once recognized as exempt;<sup>107</sup>
- The taxpaying public will have little or no ability to determine whether an organization is conforming with the purpose for which it was granted tax exemption, because (1) the IRS no longer requires the organization to describe that purpose on the Form 1023-EZ application and (2) the public has no way to determine, from reviewing the annual e-Postcard, the only information return these small organizations are required to submit, whether there has been any deviation from the (undescribed) purpose;
- Small EOs inevitably will endure “gotcha” audits because anyone – literally anyone – will be able to answer the questions on the draft Form 1023-EZ and operate for years without the IRS’s ever noticing any problems; and
- By failing to conduct a comprehensive evaluation of the downstream consequences and other impacts of the current piloted approach to streamlined EO application processing, the IRS appears to be ignoring the serious compliance concerns raised by the National Taxpayer Advocate and other stakeholders, including officials who oversee the activities of nonprofits operating at the state level.<sup>108</sup>

EO has been using streamlined procedures to process existing inventory for the past nine months at least. The National Taxpayer Advocate proposed that EO, before proceeding with Form 1023-EZ, analyze a representative sample of applications processed with streamlined procedures and determine whether the organizations are compliant. For example, if an organization was told to amend its articles of incorporation (but not required to actually demonstrate that it had done so), EO could verify whether this had been done. EO could look at the organization’s documents, websites, licensing, and information returns, among other things, to determine whether the attestations made pursuant to the streamlined procedures were reliable and whether the activities the EO is undertaking are, in fact, charitable, scientific, or educational. The efficacy of any post-exemption compliance approach EO is contemplating could be tested now, as a pilot, on a sample of organizations.

The IRS declined to adopt the National Taxpayer Advocate’s suggestion. The National Taxpayer Advocate has been advised that the IRS intends to conduct audits of a

107 Form 990-N, or e-Postcard, is submitted by organizations with \$50,000 in annual gross receipts or less. It is filed electronically and contains fields for the following information: the organization’s name; any other names the organization uses; the organization’s mailing address; the organization’s website address (if applicable); the organization’s employer identification number (EIN); the name and address of a principal officer of the organization; the organization’s annual tax period; a statement that the organization’s annual gross receipts are still normally \$50,000 or less; and if applicable, a box to indicate the organization is going out of business. See IRM 21.3.8.12.24 (Nov. 16, 2012).

108 See, e.g., Letter from President, National Association of State Charity Officials commenting on proposed Form 1023-EZ (April 30, 2014), available at <http://www.nasconet.org/wp-content/uploads/2014/05/FINAL-NASCO-comments-re-Form-1023-EZ1.pdf>; National Council of Nonprofits, *Is the 1023-EZ a Step Backward for Regulators and Nonprofits?* (June 4, 2014), available at <http://www.councilofnonprofits.org/news/council-nonprofits-news/1023-ez-step-backward-regulators-and-nonprofits>.

representative sample of EOs using the streamlined procedures at the mid- and full-year mark, and will adjust its procedures to address any noncompliance it identifies. The National Taxpayer Advocate finds this approach to determining EO eligibility misguided – walking away from the one moment in time when the IRS holds the greatest leverage to obtain compliance right from the start, and relying instead on the limited effect of a small number of audits to correct the compliance problems it creates by not ensuring compliance at the outset. No one would suggest the IRS stop preventing questionable Earned Income Tax Credit (EITC) refunds from being paid and instead rely solely on post-refund EITC audits to drive compliance. With most new EOs merely having to “attest” to their exempt purpose, the IRS significantly increases the risk of tax evasion and revenue loss.

It remains to be seen whether states that currently confer benefits on the basis of a favorable IRS determination will continue to do so for Form 1023-EZ filers.<sup>109</sup> If not, the benefits of an abbreviated form will be restricted, as organizations eligible to file Form 1023-EZ may file Form 1023 instead. Similarly, grant-making entities may require tax-exempt organizations to submit Form 1023 in order to be eligible for grants. In the meantime, Forms 1023-EZ, like inventory worked using streamlined procedures, will be processed by 25 newly-hired tax examiners and about 40 employees from the Wage and Investment division (who do not necessarily have any background in EO principles and, like the new hires, would need training unless they are merely applying a “checklist” approach to the so-called determination process).<sup>110</sup> TE/GE also announced that it would conduct predetermination checks on a statistically valid random sample of Form 1023-EZ filers “about items they have checked on the form.”<sup>111</sup>

### *EO Limited the Types of Cases that Would be Referred to EO Technical, and Provided for Administrative Review of EO Technical Determinations*

In April of 2014, TE/GE issued interim guidance that restricted matters to be referred to EO technical to:

- Applications under section 501(c)(3) from hospitals subject to requirements under section 501(r), pending training for EO Determinations personnel on this technical matter, scheduled for summer 2014;
- Applications under IRC § 501(c)(4), pursuant to the interim guidance issued on December 23, 2013, (*i.e.*, those that did not respond with the required certifications within 45 days); and

109 The Texas Comptroller of Public Accounts, for example, advises that “If your organization has received exemption from federal taxation under 501(c)(3), (4), (8), (10) or (19), it qualifies for exemption from sales tax and, if incorporated, franchise tax.” See *Frequently Asked Questions About Exemptions*, available at <http://www.window.state.tx.us/taxinfo/exempt/exemptfaq.html>.

110 See transcript of April 10, 2014 TE/GE Town Hall meeting available at <http://tege.web.irs.gov/special/comm-corner/messages/4-10-town-hall-transcript.pdf> at which the Director of Exempt Organizations discussed the hiring of 25 new tax examiners to process Form 1023-EZ applications; Wage & Investment Business Performance Review, Second Quarter 2014, (May 15, 2014), noting that “AM [the accounts management function] has approximately 40 CSRs [customer service representatives] answering TE/GE calls in the Cincinnati call site. These employees will be available to work cases for the remainder of the fiscal year, as telephone requirements allow.”

111 Fred Stokeld, *ABA Meeting: IRS Official Addresses Concerns About EO Form*, 2014 TNT 91-32 (May 12, 2014).

- Technical assistance requests pursuant to the procedures described in interim guidance issued on July 15, 2013, (*i.e.*, where a potential problem is recognized from a newspaper or magazine article; a state or local law or ordinance is recently enacted; or uncertainty exists regarding the interpretation of internal revenue laws, related statutes and regulations, published revenue rulings, revenue procedures, or any other published precedent).<sup>112</sup>

On May 7, 2014, while testifying in a hearing before the House Ways and Means Committee's Subcommittee on Oversight,<sup>113</sup> the IRS Commissioner was asked about the administrative appeal rights of certain organizations that receive a proposed adverse determination from EO Technical.<sup>114</sup> The Commissioner testified that administrative appeal rights had not previously been made available but the IRS was changing its policy to allow administrative appeal rights to these organizations.<sup>115</sup> As noted earlier, the National Taxpayer Advocate recommended that the IRS adopt such rights in her June 2013 Special Report.

On May 9, EO shared with TAS draft interim guidance for allowing administrative review of proposed adverse determinations made by EO Technical.<sup>116</sup> The guidance, which was published on May 19, 2014, permits any organization whose application has been referred to EO Technical (not only those seeking exemption under section 501(c)(4)) to request an administrative appeal of a proposed adverse determination under the same procedures applicable to organizations receiving a proposed adverse determination from EO Determinations.<sup>117</sup> The National Taxpayer Advocate welcomes this development, and notes that this approach is consistent with the principles adopted by the IRS in the Taxpayer Bill of Rights.

### *EO Extended Relief to Organizations Seeking Reinstatement of Exempt Status*

On December 19, 2013, EO shared with TAS a proposed revenue procedure that included a simplified process for obtaining reinstatement of exempt status that had been

112 See Interim Guidance, TEGE-07-0414-0009, *Identification of Cases Transferred to EO Technical* (April 8, 2014) available at [http://irm.stg.web.irs.gov/imd/ig/IG\\_Uploads/IRS.gov\\_Yes/OUO\\_No/TEGE-07-0414-0009.pdf](http://irm.stg.web.irs.gov/imd/ig/IG_Uploads/IRS.gov_Yes/OUO_No/TEGE-07-0414-0009.pdf).

113 See Written Testimony of John A. Koskinen, Commissioner, Internal Revenue Service, before the House Ways and Means Committee, Subcommittee on Oversight, *On the 2014 Filing Season and Improper Payments* (May 7, 2014), available at <http://docs.house.gov/meetings/WM/WM06/20140507/102190/HHRG-113-WM06-Wstate-KoskinenJ-20140507.pdf>.

114 As described above, pursuant to Interim Guidance, TEGE-07-1213-24, *Request for EO Technical Assistance* (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5B1%5D.pdf>, applications of organizations seeking exemption under section 501(c)(4) that did not respond with the required certifications within 45 days, or for whom EO otherwise proposed to issue an adverse determination, were referred to EO Technical for further review and then to a trio of IRS executives.

115 William Hoffman, *Exemption Applicants Can Appeal Determinations, Koskinen Says* 2014 TNT 89-3 (May 8, 2014).

116 SAMS 30178 (May 9, 2014).

117 Interim Guidance, TEGE-07-0514-0012 (May 19, 2014) available at [http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0514-0012\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/TEGE-07-0514-0012[1].pdf). For clarification about what procedures apply, see the May 15, 2014 IRS response to TAS's request for clarification, SAMS issue 30178, referencing procedures under "Rev. Proc 2014-9, section 7. Primarily 7.02, 7.05, and 7.06." The cited guidance refers to appeals of a proposed adverse determination letter issued by EO Determinations. Rev. Proc. 2014-9, I.R.B 2014-2 (Jan. 6, 2014) is available at [http://www.irs.gov/irb/2014-2\\_IRB/ar17.html](http://www.irs.gov/irb/2014-2_IRB/ar17.html).



automatically revoked for failing to file a return for three consecutive years.<sup>118</sup> The new procedures are available to organizations eligible to file Form 990-N (i.e., gross receipts of \$50,000 or less) or Form 990-EZ (i.e., gross receipts of less than \$200,000 and total assets of less than \$500,000 at the end of the taxable year).<sup>119</sup>

Among other things, under Section 4 of the guidance, eligible organizations that apply for reinstatement (using Form 1023 or Form 1024) within 15 months of the date of automatic revocation may be deemed to have had reasonable cause for failing to file the required returns and may obtain reinstatement retroactive to the date of revocation.<sup>120</sup>

The National Taxpayer Advocate welcomes this aspect of the guidance.<sup>121</sup> She remains concerned, however, about the delay in updating Select Check, the list of exempt organizations on which the public and potential donors rely, sometimes exclusively.<sup>122</sup> Because Select Check is updated only monthly, a new or newly reinstated exempt organization may lose grants or funding in the weeks it takes for its name to appear on Select Check as exempt.<sup>123</sup>

The reinstatement guidance also notes: “This rule will apply to Applications submitted before the date the IRS revises the Form 1023 and Form 1024 to permit organizations that otherwise qualify for retroactive reinstatement under this Section 4 to demonstrate reasonable cause by attesting that the organization’s failure to file was not intentional and that it has put in place procedures to file in the future. After such date, reasonable cause may be demonstrated through that attestation.”<sup>124</sup> Consistent with this provision, Part V of Form 1023-EZ, captioned Reinstatement After Automatic Revocation, permits an organization seeking reinstatement under section four of Revenue Procedure 2014-11 to attest that it “meet[s] the specified requirements of section 4, that its failure to file was not intentional, and that it has put in place procedures to file required returns or notices in the future.”

118 Under IRC § 6033(i), EOs not required to file Form 990 or 990-EZ are generally required to file Form 990-N, *Electronic Notice* (e-Postcard). IRC § 6033(j) provides for automatic revocation of tax-exempt status for failing to file a required return or e-Postcard for three consecutive years. IRC § 6033(j)(2) provides that an organization must reapply for reinstatement following automatic revocation, and IRC § 6033(j)(2) provides that the IRS can reinstate an organization’s exempt status retroactively to the date of automatic revocation if the organization shows reasonable cause for its failure to file the required return or e-Postcard.

119 The revenue procedure was published on Jan. 13, 2014 (Rev. Proc. 2014-11, 2014-3 I.R.B. 411.) This guidance is not the first time EO has provided relief to small EOs whose exempt status was automatically revoked. See National Taxpayer Advocate 2012 Annual Report to Congress 194, *Most Serious Problem: Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process are Burdening Tax-Exempt Organizations*, describing transitional relief provided in Notice 2011-43, 2011-25 I.R.B. 882. Notice 2011-43 also provided for a reduced user fee of \$100. TAS advocated for a reduced user fee for organizations applying under revenue procedure 2014-11 but EO declined.

120 Rev. Proc. 2014-11, sec. 4.

121 Rev. Proc. 2014-11, sec. 4.03 provides “For any year for which the organization was eligible to file a Form 990-N, the organization is not required to file a prior year Form 990 N or Form 990-EZ for such year.” Form 990-N cannot be filed for prior taxable years in any event. However, the IRS continues to send notices to these reinstated organizations soliciting prior year returns. See SAMS issue 30416. TAS will alert case advocates to this condition in a July, 2014 edition of the weekly all-employee TAS newsletter and will work with EO in FY 2015 to address this problem.

122 National Taxpayer Advocate 2012 Annual Report to Congress 192 (*Most Serious Problem: Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process are Burdening Tax-Exempt Organizations*).

123 See answer to question 11, *Exempt Organizations Select Check: Frequently Asked Questions, Exempt Organizations Select Check: Timing of Database Updates for Organizations Whose Exempt Status Is Reinstated*, available at <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check-Timing-of-Database-Updates-for-Organizations-Whose-Exempt-Status-Is-Reinstated>. TAS will remind case advocates of this condition in a July 2014 edition of the weekly all-employee TAS newsletter.

124 Rev. Proc. 2014-11, sec. 4.02.

The National Taxpayer Advocate believes allowing mere attestation, without a description of the procedures the organization has adopted to avert future nonfiling, is inadvisable. As with the requirement that organizations provide a narrative description of their activities in the initial application, the act of explaining in writing how the organization will avert future noncompliance would itself lead to future compliance.

### Planned Projects for FY 2015

TAS will advocate for exempt organizations by:

- Continuing to request administrative review of automatic revocations before the IRS publishes the names of an organization on the list of those no longer exempt;
- Recommending legislation that would make existing procedures similar to those under IRC § 501(h) available to 501(c)(4) applicants;
- Exploring why EO uses a system to publish the names of exempt organizations, Select Check, that is updated only monthly;
- Reviewing the IRS's procedures for monitoring compliance with all laws, rules, and regulations applicable to IRC § 501(c)(3) organizations for those organizations whose exempt status is based on Form 1023-EZ;
- Submitting a legislative recommendation that the IRS adopt an administrative review procedure that would allow organizations treated as having had their exempt status automatically revoked to demonstrate the revocation was erroneous; and
- Providing refresher guidance or training to TAS employees as necessary.

## Attachment



YOUR VOICE AT THE IRS



THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

May 27, 2014

MEMORANDUM to William J. Wilkins, Chief Counsel  
Sunita B. Lough, Commissioner, Tax Exempt and Government  
Entities Division  
Mark Mazur, Assistant Secretary (Tax Policy), U.S. Department  
of the Treasury

FROM: Nina E. Olson /s/ Nina E. Olson  
National Taxpayer Advocate

SUBJECT: Proposed IRS Form 1023-EZ and Green Circulation Draft of  
Regulations on the Streamlined Application for Recognition of  
Exemption Under Section 501(c)(3)

On March 31, 2014, the IRS made available to the public, without first consulting with the National Taxpayer Advocate, a proposed draft of IRS Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.<sup>1</sup> On May 5, 2014, TAS provided comments on draft Form 1023-EZ pursuant to internal review procedures. Those comments, together with the IRS's responses, are attached to this memo. On May 19, 2014, the IRS Office of Chief Counsel included the National Taxpayer Advocate in its circulation of proposed regulations that would amend current regulations to allow certain applicants for recognition of exempt status under IRC § 501(c)(3) to apply using Form 1023-EZ.

<sup>1</sup> The IRS notified the public it was developing a Form 1023-EZ and requested comment. Submission for OMB Review; Comment Request, 79 Fed. Reg. 18124 (Mar. 31, 2014), available at <https://www.federalregister.gov/articles/2014/03/31/2014-07066/submission-for-omb-review-comment-request>. The notice did not contain the draft Form 1023-EZ, but a copy of a Feb. 19, 2014, version of the form was available at [www.reginfo.gov/public/do/DownloadDocument?documentID=454039&version=0](http://www.reginfo.gov/public/do/DownloadDocument?documentID=454039&version=0). The draft form has since been revised, and an April 24, 2014 version is available at <http://www.irs.gov/pub/irs-dft/f1023ez--dft.pdf>.

In 2011, I called on the IRS to develop a Form 1023-EZ, and made specific suggestions about what information a Form 1023-EZ should elicit.<sup>2</sup> Exempt Organizations (EO) rejected my recommendation, stating:

The report of the National Taxpayer Advocate questions why the IRS needs all of the information requested by a Form 1023. The IRS believes that its obligation to decide whether an organization qualifies for exemption, by itself, justifies the extent of information requested on the Form 1023. The Form 1023 also serves an educational purpose because it provides applicants either an introductory or a refresher course on the rules for tax exemption. Finally, the law encourages transparency and accountability to the public by requiring organizations to make their Form 1023 exemption applications and their Form 990-series information returns available to the public.<sup>3</sup>

EO has now changed its position with respect to the benefits of a Form 1023-EZ, a welcome development. However, I am concerned the approach adopted in the proposed Form 1023-EZ and the proposed regulation for “determining” an entity’s tax exempt status goes too far in the opposite direction, effectively making a mockery of the IRS’s significant oversight function. More specifically, EO is now proposing a Form 1023-EZ that accomplishes none of the objectives it identified less than three years ago. The proposed form allows organizations simply to attest that they meet the statutory requirements for exempt status without providing documentation or detail, rendering the application process not “streamlined” but automatic and unverifiable.

My concerns with the draft Form 1023-EZ center on four specific areas: the lack of any requirement to provide a narrative statement of activities; the lack of any requirement to submit documentation; the lack of any probing questions that would reveal issues of inurement or private benefit; and the \$200,000 eligibility threshold. As a consequence, the IRS would relinquish its primary leverage to ensure an organization, at its inception, meets the criteria for tax exemption and remains compliant thereafter. The treasured exemption ruling would be issued without requiring applicants to demonstrate why, unlike other organizations, they should be exempt from paying tax.

2 National Taxpayer Advocate 2011 Annual Report to Congress 437 (*Status Update: The IRS Makes Reinstatement of an Organization’s Exempt Status Following Revocation Unnecessarily Burdensome*), available at [http://tasnew.web.irs.gov/Files/Communications/NTARReports/irs\\_tas\\_arc\\_2011\\_vol\\_1.pdf](http://tasnew.web.irs.gov/Files/Communications/NTARReports/irs_tas_arc_2011_vol_1.pdf), (noting “[f]or example, Part V, question 1b is: ‘List the names, titles, and mailing addresses of each of your five highest compensated employees who receive or will receive compensation of more than \$50,000 per year. A Form 1023-EZ could simply ask if any employees received more than \$50,000 per year in compensation from the organization. If the answer is ‘yes’, then the EO could be required to file the full Form 1023.’ I also described question 11 of Part VII as “mind-numbing” and likely inapplicable to small organizations. That question is: “Do you or will you accept contributions of: real property; conservation easements; closely held securities; intellectual property such as patents, trademarks, and copyrights; works of music or art; licenses; royalties; automobiles, boats, planes, or other vehicles; or collectibles of any type? If ‘Yes,’ describe each type of contribution, any conditions imposed by the donor on the contribution, and any agreements with the donor regarding the contribution.” See also National Taxpayer Advocate 2011 Annual Report to Congress 562 (*Legislative Recommendation: Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*), available at [http://www.taxpayeradvocate.irs.gov/userfiles/file/2011\\_ARC\\_Legislative%20Recommendations.pdf](http://www.taxpayeradvocate.irs.gov/userfiles/file/2011_ARC_Legislative%20Recommendations.pdf).

3 IRS Response, National Taxpayer Advocate 2011 Annual Report to Congress 446 (*Status Update: The IRS Makes Reinstatement of an Organization’s Exempt Status Following Revocation Unnecessarily Burdensome*), available at [http://tasnew.web.irs.gov/Files/Communications/NTARReports/irs\\_tas\\_arc\\_2011\\_vol\\_1.pdf](http://tasnew.web.irs.gov/Files/Communications/NTARReports/irs_tas_arc_2011_vol_1.pdf).

### *Substituting Attestations for IRS Review of Applications is Inconsistent with Good Tax Administration*

As a process-driven organization, the IRS routinely identifies key points of leverage to promote compliance with legal requirements. Within the EO application process, the IRS has leverage to ensure that organizations are compliant with the requirements for tax-exempt status under IRC § 501(c) – namely, that they are organized correctly (the “organizational” test) and operated correctly (the “operational” test). With the draft Form 1023-EZ and proposed regulation, EO proposes to abandon any review or level-setting of either of these foundational tests. EO, in its responses to TAS’s comments on the draft Form 1023-EZ, stated that “[m]any applicants are unsure of their proposed activities, and it takes multiple development letters to clarify the planned activities they expect to conduct.” Thus, EO appears willing to simply recognize organizations as exempt even where they *admittedly* do not actually know what their activities will be. EO also responded to TAS that “[a]llowing applicants to attest to basic operating requirements will reduce the burden of the current application process, allowing them to commence their activities more quickly. Then, if we review their activities in the future, we will have actual activities to evaluate, as opposed to planned activities that could easily change.”

This approach, apparently an inventory management technique, contravenes a core tenet of effective tax administration – that providing front-end assistance and education and establishing norms is a more effective and efficient use of resources than back-end, labor-intensive audits.<sup>4</sup> The only norm that would be established with the draft Form 1023-EZ and the proposed regulation is that exempt status would be as easy to obtain as an Employer Identification Number. In lieu of using the application process to drive compliant behavior while organizations are forming, the IRS’s proposed approach is unavoidably setting up a situation where compliance will be monitored almost exclusively through audits. Under the IRS’s proposed approach, small EOs inevitably will endure “gotcha” audits because anyone – literally anyone – will be able to answer the questions on the draft Form 1023-EZ and operate for years without the IRS’s ever noticing any problems. An organization with \$200,000 of gross receipts paying its founder a salary of \$199,000 would not, as an initial matter, attract the IRS’s attention. During the period of time before the IRS conducts an audit (if ever), tax dollars and taxpayer donations will be inappropriately diverted. For this reason, in addition to the reasons stated above, I believe the threshold eligibility for filing Form 1023-EZ should be set at \$50,000, consistent with the threshold for filers of Form 990-N (the e-Postcard).

### *Requiring Organizing Documents and a Narrative Statement Serves Applicants as Well as the IRS and the Public*

EO, in its responses to TAS, stated the form “was created to lessen the burden on the applicant and the Service.” It noted that “[p]rocessing more paper documents would utilize more

<sup>4</sup> Moreover, I note that this is the opposite of the approach the IRS is taking in the EITC area. There, it is adopting myriad front-end requirements, including demonstrations of due diligence, at the time of *filing* – i.e., at the time of *application* for the EITC – on the theory that pre-filing evidence will drive compliance.

resources, funding, and slow down the process for the other applicants in the pipeline. Additionally, F. 1023-EZ asks for state of incorporation so that taxpayers have avenue for access to articles if taxpayer does not post on Web” and “the Form 1023-EZ and any letters or other documents issued by the Service will be open to public inspection, thus meeting the requirements of IRC 6104. Form 990 would continue to be publicly accessible.” Thus, at the same time that EO expresses concern for the “burden” on new EOs to provide (1) the articles of incorporation (2) the bylaws (3) a narrative statement (4) attestations of core requirements such as having a conflicts of interest policy – all of which drive better practices and behavior at the outset of the entity’s existence - it is effectively transferring much of the responsibility for ensuring that organizations comply with tax-exemption requirements to the entire taxpaying public. The public – rather than the IRS – would be expected to police the EO sector by checking with Secretaries of State to obtain copies of articles of incorporation, and review Form 1023-EZ and Form 990.

This approach, even if it could constitute responsible tax administration, overlooks that Form 1023-EZ would provide no relevant information, and the corresponding Form 990 would have *minimal* relevant information to enable the public to fulfill this intended role. The taxpaying public would have little or no ability to determine whether the organization is conforming with the purpose for which it was granted tax exemption, because (1) the IRS would not be requiring the organization to describe that purpose on the Form 1023-EZ application and (2) the public therefore would have no way to determine, from reviewing Form 990, whether there has been any deviation from the (undescribed) purpose.

EO also responded to TAS that “[i]n many cases, articles are not dispositive, and as a practical matter, may be boilerplate.” To put it mildly, I believe this dismissal of foundational documents would be deeply concerning to State Attorneys General and State Corporation Commissions. They would likely be astonished to learn that the IRS believes the very documents that create an entity and define the scope of its activities have such limited value. Moreover, as the head of an IRS function that has recently handled between 225,000 and 300,000 taxpayer cases each year, I am not convinced that requiring documentation for key components of the application would drain IRS resources. To the contrary, if processes are properly designed and employees are properly trained, these requirements would be an effective use of the IRS’s resources – driving future voluntary compliance instead of opening the doors to non-compliance from the start.

Requiring a full description of an organization’s activities not only permits the Service to make an intelligent assessment about whether the organization meets the statutory requirements for exemption and allows the public to evaluate the organization, but equally important, it forces the submitter to think about why the organization’s activities are charitable, educational or otherwise exempt, and render it worthy of not paying taxes. I know this from first-hand experience. Prior to my appointment as the National Taxpayer Advocate, I was a tax practitioner who created and operated a tax-exempt organization and assisted other individuals seeking EO status for organizations they created and managed. I

observed repeatedly how disorganized these entities can be and how an organization may be managed by one person who has a very good and charitable idea but no infrastructure that will guard against self-inurement and other abuses. The existing requirement that tax-exempt organizations provide a narrative statement often requires organizers, for the first time, to think through the scope of their intended activities and may expose flaws in the organizers' thinking – sometimes demonstrating that an entity is essentially a sole proprietorship, or otherwise one whose activities do not meet the tests for being subsidized by the taxpaying public. Instructions will not be an effective substitute for this process. It is the *act* of having to write a statement and attach organizational documents that alerts applicants to the need to check what their documents say and make sure they are correct. Currently, for example, an applicant sees that the IRS requires certified documents with specific language pertaining to exempt purpose and dissolution. The IRS also inquires about a conflict of interest policy. This drives applicants' behavior because they know the IRS is actually looking at their documents, even if only to detect abuse.

I asked to attend the meeting to discuss draft Form 1023-EZ scheduled by the Chief Counsel for May 28, 2014, but the Chief Counsel denied my request. I therefore respectfully request that you consider these written comments at that meeting and that I have an opportunity to discuss my concerns with you directly before any decisions are made.

Attachment: May 5, 2014 TAS comments to Form 1023-EZ and IRS responses.

cc: John Koskinen, Commissioner of Internal Revenue

IMD TITLE: Form 1023-EZ, Streamlined Application for Recognition Exemption Under 501(c)(3) of IRC

SAMS ID #: 29932

DATE: 05/05/2014

REVIEWER: Taxpayer Advocate Service

CONTACT: TAS IMD/SPOC Coordinator

We suggest the following changes and/or clarifications:

IRM Subsection (or Other Document Paragraph Number) and Page Number	CURRENT TEXT (Enter the current draft text related to your comment)	TPR or TPB Issues? Y or N	TAS COMMENTS & RECOMMENDATIONS	IMD SPOC USE ONLY	Operating Division Response to TAS Comments/ Recommendations (IMD Use Only)
		Y	There should be space for a narrative description of the proposed exempt activity		---OD RESP--- Non-Adopt – Form 1023-EZ was created to lessen the burden on the applicant and the Service. We currently have an inventory that is unmanageable causing extreme wait times for § 501(c)(3) applicants. Substantial time is currently expended corresponding with applicants to perfect applications. In many cases, a narrative description is not dispositive. We considered the relative efficiencies and risks. The 1023-EZ will be used only by small (less than \$200,000 in revenue and \$500,000 in assets) and historically compliant types of organizations, limiting our risk of accepting attestations that the applicants' purposes and activities meet § 501(c)(3) requirements. Also, we have included more educational material in the F. 1023-EZ instructions to better educate the taxpayer on the requirements. Do not concur, see responses below.



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		Y	The form should require the submission of the organization's articles of incorporation.		<p>---OD RESP---</p> <p>Non-Adopt – Similar to an activity description, requiring the submission of organizing documents would cause us to follow the same processes that are currently in place for the full Form 1023. In many cases, articles are not dispositive, and as a practical matter, may be boilerplate. Requiring the submission of organizing documents would defeat the purpose of having a fully electronic submission process. Processing more paper documents would utilize more resources, funding, and slow down the process for the other applicants in the pipeline. Additionally, F. 1023-EZ asks for state of incorporation so that taxpayers have avenue for access to articles if taxpayer does not post on Web. Do not concur, see responses below.</p>
Form 1023-EZ	The form is silent on the need to file any supporting information with the application, so presumably no such requirement exists. Organizations are not required to provide copies of their organizing instrument or a narrative of planned activities.	Y	<p>I am concerned about the transparency rights all taxpayers have to review documents subject to public inspection under IRC § 6104.</p> <p>The draft Form 1023-EZ includes no narrative description of activities equivalent to Part IV of Form 1023, and any description of purpose in the organizing instrument would also be missing from the application. The public would have no way to understand the most basic purpose of the organization. Information available from the NTEE code in Part III line 1 and the checkboxes of Part III line 2 is not sufficient for the public to understand the organization's exempt purpose and methods used to fulfill its exempt purpose.</p> <p>I recommend Form 1023-EZ require that organizations file a copy of their organizing instrument with Form 1023-EZ, and Form 1023-EZ also require organizations to provide a narrative description of activities similar to Part IV of Form 1023.</p>		<p>---OD RESP---</p> <p>Non-Adopt – IRC § 6104 requires the application and any supporting documents along with any letter or other document issued by the Service with respect to such application be open to public inspection. It does not state that such application must contain an activity narrative or organizing documents. The Form 1023-EZ and any letters or other documents issued by the Service will be open to public inspection, thus meeting the requirements of IRC 6104. Form 990 would continue to be publicly accessible.</p> <p>SME Response</p> <p>I do not concur. Although the draft Form 1023-EZ might meet the letter of IRC § 6104, it does not satisfy the public interest inherent in the spirit of the law. Instead, the purpose of this form appears to be purely in the interest of ease of tax administration, so the application can be “processed,” not reviewed and approved in any meaningful way.</p>

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Form 1023-EZ	<p>The form is silent on the need to file any supporting information with the application, so presumably no such requirement exists. Organizations are not required to provide copies of their organizing instrument or a narrative of planned activities.</p>	Y	<p>This version of Form 1023-EZ not only does not serve the public interest because it promotes a lack of transparency, it also does not serve exempt organizations. Form 1023, even a Form 1023-EZ, should serve an educational purpose by providing applicants either an introductory or a refresher course on the rules for tax exemption. It should force organizations, perhaps for the first time, to articulate what activities they intend to conduct and how those activities further an exempt purpose. It should draw attention to the rules on inurement and private benefit. It should ensure organizing documents contain appropriate clauses, with which the founders are acquainted.</p> <p>The form as drafted is an abdication of the IRS's responsibility to determine, beyond relying on attestations by its organizers, whether an organization is exempt.</p>		<p>---OD RESP---</p> <p>Non-Adopt – Educational information regarding the rules for tax exemption are contained in the 1023-EZ instructions and other documents such as Publication 557, referenced in the 1023-EZ instructions. These documents clearly explain the requirements the applicant is attesting it meets under the penalties of perjury. The IRS is still upholding its responsibility of reviewing applications and determining, based on representations, that the applicant meets § 501(c)(3) requirements. Congress enacted the F. 1023 requirement in § 508 not for an educational purposes but because it “believe[d] that the Internal Revenue Service has been handicapped in evaluating and administering existing laws by the lack of information with respect to many existing organizations.” S. Rep. 91-552, 91st Cong. 1st Sess. 1969 USCCAN 2027, 2081.</p> <p>Do not concur, and evidently EO is changing its position. The yellow highlighted portion above is a direct quote from EO’s response to the National Taxpayer Advocate’s 2011 Annual Report to Congress (page 446) available at <a href="http://tasnew.web.irs.gov/Files/Communications/NTARReports/irs_tas_arc_2011_vol_1.pdf">http://tasnew.web.irs.gov/Files/Communications/NTARReports/irs_tas_arc_2011_vol_1.pdf</a>.</p>

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1023-EZ	<p>1) Parts II allow organizations to attest that they have an organizing document and required verbiage to meet the organizational test under 501(c)(3).                      2) Part III allow organizations to attest to their exempt activities.</p>	Y	<p>Form 1023-EZ will be filed electronically; without an organizational document or a narrative of activities. Under IRC § 6104, the public has the right to review the application and annual information returns to ensure confidence. Based on this form and the possibility many of these organizations will only file form 990-N, there will be minimum transparency of public charities' activities.</p> <p>I am also concerned applicants will not be in compliance with exempt tax law. Under IRC § 501(c)(3), if an organization fails to meet either the organizational or operational test, it is not exempt.</p> <p>I recommend applicants submit copies of their organizational documents if it not available for review on the State's website. Also there should be a fill in section included on Form-EZ for applicants to list a narrative of their activities.</p>		<p>---OD RESP---</p> <p>Non-Adopt – Reasons for not requiring the submission of organizing documents or narrative descriptions of activities are explained above.</p> <p>Additionally, we would like to point out the following. The current method of soliciting narratives of proposed activities on Form 1023 can be very time-consuming, and as a result increase wait times for other applicants. Many applicants are unsure of their proposed activities, and it takes multiple development letters to clarify the planned activities they expect to conduct. Generally, the current process does not yield valuable information.</p> <p>Allowing applicants to attest to basic operating requirements will reduce the burden of the current application process, allowing them to commence their activities more quickly. Then, if we review their activities in the future, we will have actual activities to evaluate, as opposed to planned activities that could easily change.</p> <p>RATA's response – Do not concur : I agree with the SME's comments. Also, this process opens up exempt organizations to abuse. Applicants don't have to even be a business entity to obtain an exemption. What happens in the future if you find inurement or private benefit on a public charity other than revoking the organization?</p>

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1023-EZ	Without a narrative or financial information there is no place on Form 1023-EZ to indicate if organizations are required to file Form 941 for their employees.		<p>New exempt organizations are not aware of their obligations to file tax return for their employees. I suggest adding another question to alert organizations of their responsibilities.</p> <p>Example: Do you or will you pay wages to employees? (If yes, consider filing Form 941, see Publication 557, <i>Tax Exempt Status for Your Organization</i>.)</p>	P	<p>--OD RESP-- Non-Adopt – Employment tax responsibilities are not exclusive to exempt organizations. All entities with employees are required to file Form 941. Numerous IRS documents and publications describe these responsibilities (including publication 557 referenced several times in the 1023-EZ instructions). It is the taxpayers' responsibility to understand and comply with these requirements. It is not a specific requirement for exemption and is not needed on the Form 1023-EZ to make a determination.</p> <p>RATA's response I concur.<sup>5</sup></p>

<sup>5</sup> Some of the comments in this column, including those disputing an IRS position, are TAS comments. RATA stands for Revenue Agent Technical Advisor; SME is Subject Matter Expert.