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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

April 26, 2012

The Honorable Darrell E. Issa
Chairman
Committee on Oversight and Government Reform
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am responding to your letter dated March 27, 2012, requesting information about the tax-exempt sector. We appreciate your interest and support of the IRS efforts in the administration of the tax law as it applies to tax-exempt organizations.

The conference call with your staff on April 4, 2012 was a helpful exchange that better enabled us to provide pertinent information in this response. We clarified that no questionnaires connected to the project mentioned in the EO 2012 Work Plan have been sent to any organization. That project is still in process and we have not yet completed development of the questionnaire. The Section 501(c)(4), (5) and (6) Project described in the EO 2012 Work Plan relates to organizations that self-declare and hold themselves out as being tax-exempt rather than seeking IRS recognition of their exempt status. The law allows these organizations to self-declare and hold themselves out as tax-exempt. Organizations also can apply for IRS recognition as tax-exempt. An organization determined by the IRS to be tax-exempt can rely on that determination if their exempt status is ever questioned, so long as the organization has not deviated from the organizational structure and operational activities set forth in its application.

Based on that clarification, and per our discussion with your staff, we understand that references in your letter to "questionnaires" are not intended to relate to the EO 2012 Work Plan project. Rather, those references relate to development letters the IRS sends to organizations in the ordinary course of the application process to obtain the information as the IRS deems necessary to make a determination whether the organization meets the legal requirements for tax-exempt status.

Pursuant to the direction of your staff, we are responding to your questions as modified per our discussion of April 4.

Overview of the application process for section 501(c)(4),(5), and (6) organizations (requested in lieu of questions 1 and 2).

All applications for tax-exempt status, including applications for status under section 501(c)(4), are filed with a centralized IRS Submission Processing Center, which enters the applications into the EP/EO Determination System and processes the attached user fees. The application is then sent to the Exempt Organizations ("EO") Determinations office in Cincinnati, Ohio for initial technical screening.

This technical screening is conducted by EO Determinations' most experienced revenue agents who review the applications and, based on that review, separate the applications into the following four categories:

- Applications that can be approved immediately based on the completeness of the application and the information submitted;
- Applications that need only minor additional required information in the file in order to approve the application;
- Applications that do not contain the information needed to be considered substantially complete; and
- Applications that require further development by an agent in order to determine whether the application meets the requirements for tax-exempt status.

Organizations whose applications fall into the fourth category are sent letters informing them that more development of their application is needed, and that they will be contacted once their application has been assigned to a revenue agent. The applications are sent to unassigned inventory, where they are held until a revenue agent with the appropriate level of experience for the issues involved in the matter is available to further develop the case.¹

Once the case is assigned, the revenue agent notifies the organization and reviews the application. Based upon established precedent and the facts and circumstances set forth in the application, the revenue agent requests additional information and documentation to complete the file pertaining to the exempt status application materials² (the so-called "administrative record") and makes a determination. Where an application for exemption presents issues that require further development to complete the administrative record, the revenue agent engages in a back and forth dialogue with the organization in order to obtain the needed information. This back and forth dialogue helps applicants better understand the requirements for exemption and what is needed to meet them, and it helps the IRS obtain all the information relevant to the determination.

¹ Enclosure A describes the criteria used to determine the appropriate level of experience.

² This includes the application for recognition of tax exempt status, any papers submitted in support of the application, and any letter or other document issued by the IRS with respect to the application. See IRC § 6104(a), (d)(5); Tax Court Rule 210(b)(12).

Tools are available to promote consistent handling of full development cases. For example, in situations where there are a number of cases involving similar issues (such as credit counseling organizations, down payment assistance organizations, organizations that were automatically revoked and are seeking retroactive reinstatement, and most recently, advocacy organizations), the IRS will assign cases to designated employees to promote consistency. Additionally, in these cases, EO Technical (an office of specialists in Exempt Organizations) works with the IRS Office of Chief Counsel to develop educational materials to assist the revenue agents in issue spotting and crafting questions to develop cases consistently.

It is important to develop a complete administrative record for the application. The administrative record must be complete so that it either supports exemption or denial. If the application is approved, not only is the administrative record made publicly available (with certain limited exceptions outlined below), but organizations that act as described in the administrative record have reliance on the IRS determination. If the application is denied, the organization may seek review from the Office of Appeals. That Office, which is independent of Exempt Organizations, reviews the complete administrative record and makes its own independent determination of whether the organization meets the requirements for tax-exempt status. It is to the organization's benefit to have all of its materials in the file in the event EO Determinations denies exemption and the organization seeks Appeals review. If, based on the information in the administrative record, the Appeals Office decides the organization meets the requirements for tax-exempt status, the application will be approved. If the Appeals Office agrees that the application should be denied, the applicant may seek relief by paying the tax owed as a taxable entity and seek a refund in federal court.

In those cases where the application raises issues for which there is no established published precedent or for which non-uniformity may exist, EO Determinations refers the application to EO Technical. In EO Technical, the applications are reviewed by tax law specialists whose job is to interpret and provide guidance on the law and who work closely with IRS Chief Counsel attorneys on the issues.

Similar to the process in EO Determinations, EO Technical tax law specialists develop cases based on the facts and circumstances of the issues in the specific application. EO Technical staff engages in a back and forth dialogue with the organization in order to obtain the information needed to complete the administrative record. If, upon review of all of the information submitted, it appears that an organization does not meet the requirements for tax-exempt status, a proposed denial explaining the reasons the organization does not meet the requirements is issued. The organization is then entitled to a "conference of right" where it may provide additional information. Following the conference of right, a final determination is issued. If the application is approved, the administrative record is made publicly available, and if the organization acts as described in the application filed, it has reliance on the IRS determination. If the application is denied, the applicant may seek relief by paying the tax owed as a taxable entity and seek a refund in federal court.

The average case processing time for determination cases closed in FY 2011 was 104 days. However, it is difficult to predict how long it will take to fully process any specific application. Case processing time can vary greatly depending on a number of factors, including whether a case can close through technical screening or requires full development, the availability of an agent with the appropriate experience level to fully develop the application, the particular issues and individualized facts and circumstances presented in the application, the back and forth dialogue between the agent and the applicant to fully develop the application, and whether a case is transferred to EO Technical.

Question 3. A chart showing the number of applications for tax exempt status for all 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6) applications, filed by organizations since January 1, 2009. This chart should include the number of applications that have been approved, the number that have been denied, and the number that are still pending for each application type.

Reports of the IRS data requested are created and published in the IRS Data Book by the IRS Statistics of Income (SOI) Division. The Data Book provides information on IRS activities conducted during a fiscal year period (October 1 through September 30). We have attached as Enclosures B-1 through B-3, Table 24: Closures of Applications for Tax-Exempt Status by Organization Type and Internal Revenue Code Section, data book information for fiscal years 2009 through 2011.³

In addition, we have provided the following supplementary charts.⁴

³ Reports of the IRS data requested are created and published by Statistics of Income (SOI) Division. The IRS Data Book provides information on IRS activities conducted during a fiscal year period (October 1 through September 30). Data Book information is updated annually, and is available to the public at <http://www.irs.gov/taxstats/index.html>. Data on Table 24 reflects all case closures for the Exempt Organizations Determinations function. These include not only initial applications for tax-exempt status, but also other determinations, such as public charity and private foundation status determinations, advance approval of scholarship grant procedures, and group determinations of tax-exempt status.

⁴ The data for FY 2012 in the supplemental charts reflects the preliminary information available. SOI Data Book information is updated annually, with the complete FY 2012 information expected in March 2013.

The chart immediately below supplements the enclosed SOI Table 24 data to show the number of cases closed that have resulted in approved or disapproved applications. The chart reflects the available preliminary information on case closures for FY 2012, from October 1, 2011 through April 11, 2012.

FY 2012	Closed Applications for Tax-Exempt Status			
Subsection	Approved	Disapproved	Other⁶	Total
501(c)(3)	22,897	81	2,872	25,850
501(c)(4)	1,069	6	172	1,247
501(c)(5)	234	0	31	265
501(c)(6)	853	8	82	943

As of April 2, 2012, the IRS has the following number of pending applications:

Subsection	Case Type		Total Pending
	New (Initial) Applications	Other⁷	
501(c)(3)	26,467	414	26,881
501(c)(4)	1,472	9	1,481
501(c)(5)	492	0	492
501(c)(6)	807	*	80X

* 3 or less

⁵ These include not only initial applications for tax-exempt status, but also other determinations, such as public charity and private foundation status determinations, advance approval of scholarship grant procedures, and group determinations of tax-exempt status.

⁶ These include applications withdrawn by the organization; applications that did not provide the required information; incomplete applications; IRS refusals to rule on applications; applications forwarded to other than the Washington, DC office; IRS correction disposals; and others.

⁷ These include applications for determinations other than initial applications for tax-exempt status, such as public charity and private foundation status determinations, advance approval of scholarship grant procedures, and group determinations of tax-exempt status.

The following two charts reflect the number of applications filed or received for FY 2009 -2011 and the available information for FY 2012, from October 1, 2011 through April 1, 2012 for sections 501(c)(3) through 501(c)(6).

**Determination Case Receipts by Type and Subsection
for Fiscal Year 2009-2011**

	Application Receipts	New (Initial) Applications	Other ⁸
Form Number	Subsection		
1023	501(c)(3)	158,531	24,905
1024	501(c)(4)	5,404	347
1024	501(c)(5)	1,188	54
1024	501(c)(6)	5,064	237
Total Receipts by Type		170,187	25,543
Total of All Specified Receipts		195,730	

**Determination Case Receipts for Fiscal Year 2012
October 1, 2011 through April 1, 2012**

	Application Receipts	New Applications	Other ⁹
Form Number	Subsection		
1023	501(c)(3)	33,307	529
1024	501(c)(4)	1,715	8
1024	501(c)(5)	563	0
1024	501(c)(6)	1,240	*
Total Receipts by Type		36,825	53X
Total of All Specified Receipts		37,364	

* 3 or less

⁸ Id.

⁹ Id.

Question 4. A list of all the organizations that the IRS sent these types of questionnaires to this year, the date the questionnaire was sent by the IRS, the date the IRS asked for a response, and the date the organizations sent their initial application for tax exempt status (per discussion with staff, response to address development letters).

Section 6103 of the Internal Revenue Code prohibits the disclosure of information about specific taxpayers unless the disclosure is authorized by some provision in the Internal Revenue Code. Section 6104(a) of the Code permits public disclosure of an application for recognition of tax exempt status and supporting materials only after the organization has been recognized as exempt. Consequently, we cannot provide a list of organizations that have received development letters from the IRS, until those applications have been approved.¹⁰

The chart below provides the number of application closures for sections 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6) approved between January 1, 2012 through April 18, 2012 that required full development and, therefore, received development letters during the processing of the application.

Although we are able to produce the number of cases approved during this time period that received development letters, manual review of each file would be necessary to determine the particular organization and the development letters sent. We are available to work with your staff to identify the information that we are able to legally provide that would be relevant to your request.

**Fully-Developed Determination Applications that Closed Approved
January 1, 2012 through April 18, 2012**

Subsection	Approved Fully-Developed Closures
501(c)(3)	2,819
501(c)(4)	141
501(c)(5)	7
501(c)(6)	52

Question 5. A list of the objective criteria the IRS used for determining which groups would be sent these types of questionnaires (per discussion with staff, response to address development letters).

As discussed above, the IRS contacts the organization and solicits additional information when the organization does not provide sufficient information in response to the questions on the Form 1024 or if issues are raised by the application. When an application needs further development, the case is assigned to a revenue agent with the appropriate level of experience for the issues involved in the application.

¹⁰ See disclosure discussion in response to Request # 6, infra.

The general procedures for requesting additional information to develop an application are included in section 7.20.2 of the Internal Revenue Manual. Although there is a template letter that describes the general information on the case development process, the letter does not, and could not, specify the information to be requested from any particular organization because of the broad range of possible facts. Enclosure C is a copy of the template letter.

The amount and nature of development necessary to process an application to ensure that the legal requirements of tax-exemption are satisfied depends on several factors, which include the comprehensiveness of the information provided in the application and the issues raised by the application. Consequently, revenue agents prepare individualized questions and requests for documents relevant to the application, which are attached to the above described general template letter. With certain types of applications where the issues are similar or more complex, EO Technical, in coordination with Chief Counsel, develops educational materials to assist the revenue agents in issue spotting and crafting questions to develop those cases consistently.

The revenue agent uses sound reasoning based on tax law training and his or her experience to review the application and identify the additional information needed to make a proper determination of the organization's exempt status. The revenue agent prepares individualized questions and requests for documents based on the facts and circumstances set forth in the particular application.

Once responses are received, the entire application file is evaluated based upon the requirements in the Code and regulations.¹¹

Question 6. IRS Form 1040 does not require organizations applying for tax exempt status to provide specific donor information for donors giving less than \$5,000 a year. In addition, the names and addresses of donors giving the organization at least \$5,000 were not made public by the IRS. However, many of the IRS questionnaires sent to organizations seeking 501(c)(4) status specifically ask for all the organization's donors and the amounts of each of the donations.

The IRS has informed the organizations that it plans to make this donor information public. Provide all documents and communications referring or relating to the decision to ask for this type of donor information and to make this information public.

Based on our discussion with your staff on April 4, 2012, we understand this request is intended to refer to IRS Form 990 rather than Form 1040 as noted in the request. The Form 990, *Return of Organization Exempt from Income Tax*, is the annual information return filed by tax exempt organizations.

¹¹ IRC § 501(c)(4); Treas. Reg. § 501(c)(4)-1.

As explained above, when a Form 1024 application needs further development, the IRS contacts the organization and solicits additional information in order to have a complete administrative record on which the IRS can make a determination as to whether the requirements of the Code and regulations are met. There are instances where donor information may be needed for the IRS to make a proper determination of an organization's exempt status, such as when the application presents possible issues of inurement or private benefit. Nevertheless, the IRS takes privacy very seriously, and makes an effort to work with the organization to obtain the needed information so that the confidentiality of any potentially sensitive or privileged information is taken into account. We have advised applicant organizations that if they believe that the requested information required to demonstrate eligibility for section 501(c)(4) status can be provided through alternative information, they should contact the revenue agent assigned to their application. As discussed above, we will consider whether compliance with the legal requirements can be satisfied in the alternative manner proposed. We have also provided additional time to respond.

IRS policy or practice does not govern whether or not donor information is made public. This matter is governed by statute. Public disclosure regarding tax exempt organization filings is principally governed by sections 6104 and 6110 of the Internal Revenue Code.

Section 6104 of the Code requires the IRS to make certain materials available for public inspection, including an organization's application for recognition of tax exemption and Form 990 annual information returns.¹² If the IRS approves an organization's application for tax-exempt status, section 6104(a) requires that the application and supporting materials be made available for public inspection. The only exception to that requirement is found in section 6104(a)(1)(D), which exempts from disclosure information that the IRS determines relates to any "trade secret, patent, process, style of work, or apparatus of the organization" that would adversely affect the organization or information that could adversely affect national defense.

The long-standing statutory requirements regarding exemption applications, including Form 1024, are separate from those requiring public availability of Form 990 annual information returns, which are contained in section 6104(b). Under section 6104(b), Form 990 annual information returns are also subject to public inspection, with the sole exception of donor information contained in Schedule B of the Form 990. The withholding of names and addresses of donors from public disclosure applies only to Form 990; this exception does not extend to information obtained from Form 1024 and supporting materials.¹³

¹² The disclosure rules have been in place since 1958, and the legislative history provided the following rationale for public disclosure of exemption applications: "[the] committee believes that making these applications available to the public will provide substantial additional aid to the Internal Revenue Service in determining whether organizations are actually operating in the manner in which they have stated in their applications for exemption." H.R. Rep. No. 85-262, at 41-42 (1957). In 1987, Congress added what is now section 6104(d) to the Code, that requires organizations to make their returns available to the public, and in 1996 extended this rule to application materials.

¹³ The withholding exception does not apply to donor information for organizations that file Form 990-PF or to those section 527 organizations that are required to file Form 990 or 990-EZ.

In light of the statutory requirement to make approved applications public, organizations are notified that information they provide will be available for public inspection on page 2 of the Form 1024 instructions. This notice is reiterated in any development letters sent to the organizations. Although the statute requires the administrative record, including the application, supporting documents and correspondence between the applicant and the IRS, be made available for public inspection, the IRS does not affirmatively publish this information. It is available only upon request.

Additionally, under section 6110 of the Code, if the IRS ultimately denies the application for recognition of tax-exempt status, the denial letter and background information will be subject to public inspection, with certain identifying and other information redacted, to assist the public to understand the IRS reasoning while also protecting the identity of the organization and any person identified in the file (including individual donors).

Question 7. Each of the requests for information, listed below that has appeared on an IRS questionnaire is beyond the scope of IRS Form 1024. For each of these requests, listed below, please state: a) the IRS's authority for asking for the information; b) the IRS's rationale for needing this piece of information; c) whether any precedent exists for the IRS asking for this type of information; d) the objective standards the IRS will use when reviewing the response; and e) how the IRS will use the information to determine tax-exempt status.

We are working on a detailed response to the question and will provide it in a supplemental response.

I hope this information is helpful. If you have questions, please contact me or have your staff contact Cathy Barre at (202) 622-3720.

Sincerely,



Lois G. Lerner
Director, Exempt Organizations

Enclosures