**WRITTEN TESTIMONY OF**
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**BEFORE THE**
**SENATE FINANCE COMMITTEE**
**ON THE IRS'S RESPONSE TO THE COMMITTEE REPORT ON THE PROCESSING OF APPLICATIONS FOR TAX-EXEMPT STATUS**
**OCTOBER 27, 2015**

## INTRODUCTION

Chairman Hatch, Ranking Member Wyden and Members of the Committee, thank you for the opportunity to discuss the IRS's response to the Committee's report on its investigation into the processing of applications for tax-exempt status under section 501(c) of the Internal Revenue Code. The Committee's investigation followed a report issued in May 2013 by the Treasury Inspector General for Tax Administration (TIGTA) on the IRS's use of improper criteria in the determination process for 501(c)(4) applications.

Let me begin by reiterating what I have said earlier in my tenure as IRS Commissioner. The situation described in the Inspector General's 2013 report should never have happened, and the IRS is doing everything possible to ensure that the mistakes referenced in the Inspector General's report do not happen again. Every taxpayer, whether an individual or an organization, needs to be confident that they will be treated fairly by the IRS, no matter what their political affiliation, their position on contentious political issues, or whom they supported in the last election.

Even with our declining resources, we will still audit over 1 million taxpayers this year. And when someone hears from us regarding their tax return – by letter, I should add, in light of the recent proliferation of IRS impersonation telephone scams – they need to understand that it is only because of something that is or should be in their tax return, and not other factors. And, if someone else has the same issue in regard to their return, they will hear from us as well, within the limits of our budget resources.

A shared belief in the fairness of our tax system and its administration is fundamental to the voluntary compliance by our citizens with the requirements of our tax laws. This compliance provides the vast majority of the over $3 trillion in revenue that we collect for the nation every year. We are the stewards of this system and take our responsibility seriously.

As part of our work to move forward, we have implemented all of the recommendations made by the Inspector General in his May 2013 report. The changes we made in response to those recommendations include: eliminating the use of inappropriate criteria; expediting the processing of section 501(c)(4) applications; establishing a new process for documenting the reasons why applications are chosen for further review; developing guidelines for specialists in the IRS's Exempt Organizations (EO) division on how to process requests for tax-exempt status involving organizations engaging in potentially significant political campaign intervention; and creating a formal, documented process for EO determinations personnel to request assistance from technical experts. EO is committed to providing annual training for employees on political campaign intervention.

The Inspector General reviewed our actions and issued a follow-up report in March of this year, noting that the IRS had taken "significant actions" to address his recommendations.

**RESPONDING TO THE COMMITTEE REPORT**

We appreciate the enormous amount of hard work done and time spent by the Committee and its staff in investigating this matter and developing the report that is the subject of today's hearing. By its thorough and detailed nature, the Committee's report provides a full account of the IRS's section 501(c)(4) processing issues.

It is important to note that the IRS cooperated fully with the Committee's investigation and the investigations conducted by other Congressional committees, the Inspector General and the Department of Justice. Our efforts resulted in the production of more than 1.3 million pages of unredacted documents to this Committee and the House Ways and Means Committee, including approximately 80,000 emails sent or received by former Director of Exempt Organizations Lois Lerner. More than 250 IRS employees spent more than 160,000 hours working directly on complying with the investigations, at a cost to the agency of approximately $20 million.

I am pleased to report, as I advised the Chairman and the Ranking Member by letter earlier, that the IRS has accepted all the recommendations in the Committee's report that are within our control – those that did not involve tax policy matters or legislative action. They include 15 of the report's 18 bipartisan recommendations and also six of the recommendations in the separate sections prepared by the Majority and Minority. I have attached a copy of my letter to this testimony for inclusion in the record.

The IRS has already made significant progress in implementing the Committee's recommendations within our control. In part, this is because a number of the Committee's recommendations overlap with the recommendations of the May

2013 Inspector General's report noted above. In addition, we have been working diligently over the last three months to implement those recommendations made by the Committee that do not overlap with those of the Inspector General.

## IMPROVING PROCESSES IN THE EXEMPT ORGANIZATIONS AREA

Following is an overview of the significant actions that we have already taken or are taking in response to the Committee's recommendations. For the sake of brevity, we have grouped our actions into 10 broad categories that reflect the Committee's major concerns in relation to the processing of applications for tax-exempt status. The categories are as follows:

***Promoting Transparency and Accessibility in the Exempt Organizations Determination Process.*** The IRS has taken a number of actions to ensure that the determination process for organizations applying for tax-exempt status is transparent, and that the public can easily obtain information on our procedures. For example, since the release of the Inspector General's May 2013 report, EO has made significant progress in facilitating public access to relevant materials through substantive updates to the Internal Revenue Manual (IRM) sections and revenue procedures that relate to the application process. These resources continue to be available to the public via the IRS website, IRS.gov. Moving forward, EO will review the instructions for the IRS forms that organizations use when applying for tax-exempt status, and will add references to the resources available on IRS.gov as needed.

***Streamlining the Exempt Organizations Determination Process to Ensure Timely Processing and Reduce Delay***. EO is committed to processing applications for tax-exempt status in a timely manner and resolving all determination cases within 270 days as recommended by the Committee. The IRS has taken a number of actions since the beginning of the Committee's investigation that have been designed to reduce processing times and eliminate any backlog. For example, in 2014 EO began tracking cases once they became 90 days old to ensure that potential barriers to resolution were addressed early on. This action and others complemented measures already adopted in response to the Inspector General's 2013 report, including the "Optional Expedited Process" for 501(c)(4) organizations with potential political campaign intervention activities. As a result of our actions, the average age of the application inventory has been significantly reduced. From April 2014 to July 2015, applications submitted on Forms 1023 – which are used by organizations applying for 501(c)(3) status and make up the majority of the EO application inventory – dropped from an average age of 256 days to 107 days. Applications submitted on Forms 1024 – which are used by organizations applying for tax-exempt status under section 501(c)(4) and other Code sections – went from an average age of 256 days to 112 days. The IRS will continue its efforts to further reduce any over-age inventory among applications for tax-exempt status.

***Realigning Organizational Functions for Improved Service****.* One of the concerns raised in the Committee's report in regard to the management problems at the IRS in 2013 involved the decentralization of EO leadership and employees. The IRS has made several notable structural changes to enable performance improvements. For example, the positions of EO Director and EO Director of Rulings and Agreements were relocated from Washington, D.C. to Cincinnati, Ohio, so the EO leadership is now located with most EO employees who process applications for tax-exempt status. Additionally, the Tax Exempt/Government Entities Division (TE/GE) worked closely with the Office of Chief Counsel to move functions performing legal analysis from TE/GE to Chief Counsel. As a result, there is now a clear separation of duties, as well as well-defined procedures and improved lines of communication between TE/GE leaders and their counterparts in the Office of Chief Counsel.

***Fostering a Culture of Accountability.*** The IRS has taken a number of steps to ensure that TE/GE employees, managers and leadership operate in an environment of accountability in regard to the processing of applications for tax-exempt status. For example, all TE/GE managers are now required to conduct regular workload reviews with their employees. In addition, the results of these reviews are shared with the senior leadership of each function, and the TE/GE Commissioner holds monthly Operational Reviews with each functional director. Information on the amount of time it takes to process cases is provided on a regular basis up the management chain, not only to TE/GE leadership but also to the IRS Commissioner and the Deputy Commissioner for Services and Enforcement. We believe this focus on case processing oversight directly contributes to, and ensures, improved processing times and reduced inventory. I would also note that the entire leadership chain of command, starting with the Commissioner's office and running down to the Director of Exempt Organizations and her direct reports, was replaced over two years ago.

***Strengthening Risk Management through Improved Communication.*** The IRS has worked to ensure risks are managed more effectively throughout the organization, and within TE/GE in particular. In 2014, the IRS established an agency-wide enterprise risk management program, creating risk management liaisons in each area of our operations and providing for the regular identification and analysis of risks to be eliminated or managed across the agency. We are working to create a culture where employees are encouraged to think of themselves as risk managers and to report any issues or problems that occur. We are encouraging the further flow of information from front-line employees up through the organization as well as out to the front line from senior managers. As part of this program, TE/GE and the other IRS business divisions each established a new Risk Management Process to enable certain issues to be elevated to the executive leadership for review and discussion. This new and expansive process further mitigates the risk that sensitive issues may not be elevated in a timely manner.

***Bolstering Employee Training.*** In response to the Inspector General's 2013 report, EO began developing new training and workshops for employees on a number of critical issues connected with the application process for tax-exempt status, including the difference between issue advocacy and political campaign intervention, and the proper way, under current law, to identify applications that require review of potentially significant political campaign intervention. EO is continuing to develop new ways of delivering and sharing training materials and technical expertise. For example, to respond to the Committee's interest in this area, EO conducted training this fall for determination specialists on quality standards, including standards for timely case processing. TE/GE is also implementing a "knowledge management" network which, when completed, will provide TE/GE employees with easy access to information on a wide range of technical issues, such as those involving unrelated business income tax, private foundations and employee plans.

***Ensuring Neutral Review Processes.*** The IRS has taken a number of actions to ensure that a neutral review process exists for organizations applying for tax-exempt status. For example, in response to the Inspector General's 2013 report, the IRS provided guidance to EO employees on the proper way to process applications for tax-exempt status when an organization does not provide the IRS with sufficient information to reach a conclusion about the application. In 2014, the IRS implemented new procedures to ensure that requests for additional information in cases involving potential political campaign intervention activities are appropriate in scope and scale. These include the development of a template letter, Letter 1312, "Request for Additional Information," to better standardize such requests. In addition, the Department of the Treasury and the IRS are in the process of developing guidance on social welfare and non-social welfare activities of 501(c)(4) organizations. Our efforts to develop this guidance have been greatly informed by the more than 160,000 public comments received in response to the 2013 proposed regulations. We asked for, and received, comments on several issues, including three major ones: the proposed definition of political campaign activity; to which organizations that definition should apply; and the amount of political activity an organization can engage in consistent with a particular tax-exempt status. Our goal is to provide guidance that is clear, fair to everyone, and easy to administer. I am attaching for the record a summary of the comments received on these three major issues.

***Improving Procedures under the Freedom of Information Act.*** The IRS is taking several actions in response to the concern expressed by the Committee in its report that IRS employees did not properly respond to certain FOIA requests, including requests regarding groups applying for tax-exempt status. To ensure that employees responsible for responding to FOIA requests have the tools they need to conduct robust searches for such requests, which are increasingly complex in scope and volume, the IRS's Disclosure Office is preparing guidance in the form of written standard search procedures. This guidance will focus on many of the more frequently requested categories of information, and will include

contact lists. Employees processing FOIA requests will be trained in those procedures by the end of 2015. Additionally, EO in May 2015 released new procedures for handling FOIA requests involving the Exempt Organizations area, which will help ensure searches are appropriately conducted across all components of the EO function, as recommended by the Committee.

***Reviewing the Use of the Office Communicator System.*** In its report, the Committee raised important questions about records retention, as well as questions regarding IRS employees' use of the Office Communicator System (OCS). Similar to an internal instant messaging system, OCS enables IRS employees to hold virtual meetings and virtual training events involving large numbers of employees and offices. Employees also use OCS as an informal means of communication. Currently, the IRM advises employees who create Federal records using informal means of documentation or communication, including OCS, to convert those records to a more structured format to facilitate records management and enable appropriate retention. The IRS is working with the National Archives and Records Administration (NARA) on these issues and plans to improve this guidance by adding more specific instructions and clarifying examples.

***Responding to Government Accountability Office (GAO) Recommendations.*** In June 2015, the GAO released a report on the criteria the IRS uses to select exempt organizations for audit. In this report, the GAO found no evidence of organizations being selected in an unfair or biased manner. At the same time, the GAO also identified areas where EO's system of internal controls for the audit selection process could be improved in order to reduce the risk of returns being selected for audit in an unfair or biased manner. When the report was released, the IRS agreed with the GAO's recommendations, and stated that it was in the process of implementing them. The Committee has also recommended that the IRS implement the GAO's recommendations, and we are continuing to do so, tightening the internal controls for the audit selection process.

## ENHANCING RECORDS RETENTION PROCEDURES

The investigations into the determination process for tax-exempt status also raised another issue that we have been working to address, and that is the need to ensure that electronic media containing important records are preserved and protected. This issue was brought into focus with the Inspector General's release of a report on June 30, 2015, on the IRS's production of emails relevant to the investigations by the Committee, the Inspector General and others into the issues surrounding the processing of applications for tax-exempt status.

The Inspector General's June 2015 report described difficulties encountered in searching for emails and retrieving them from the IRS's outdated system for electronic records retention. This included the erasure in March 2014 of 422

disaster recovery tapes associated with a decommissioned IRS email server, which occurred despite instructions issued to agency employees in May 2013 to preserve these types of records.

The Inspector General's June 2015 report stated the IG had uncovered "no evidence that the IRS employees involved intended to destroy data on the tapes or hard drives in order to keep this information from the Congress, the DOJ or TIGTA." Nonetheless, the IRS's failure to ensure employees followed the document preservation instructions is clearly unacceptable.

With the benefit of the Inspector General's report, the IRS has been making significant progress in implementing records management improvements. Specifically, we have initiated a process to secure the email records of all senior officials in the agency, including having all files archived to the network rather than relying on individual hard drives. We are also implementing records management improvements based on recommendations from NARA.

Additionally, we have worked to increase training of front-line information technology (IT) employees on document preservation issues, to exert greater control over the management of our email server backups, and to continue the preservation of all disaster recovery tapes. Collectively, these steps have helped the IRS create better policies and procedures to minimize the risk of future data loss incidents.

## ADDRESSING OTHER CRITICAL TAX ADMINISTRATION ISSUES

While the IRS is working to complete the implementation of the Committee's recommendations in regard to the processing of applications for tax-exempt status, we also appreciate the bipartisan efforts being made by the Committee on other issues critical to taxpayers and tax administration.

One important issue involves pending legislation to extend a group of tax provisions that expired at the end of 2014. The uncertainty we face over the timing of the extenders legislation raises operational and compliance risks for the IRS's delivery of the upcoming tax filing season beginning in January and for everyone involved in tax administration. We are grateful for the Committee's efforts to ensure that Congress makes a decision, one way or another, on this legislation in a timely manner.

If the uncertainty over this legislation persists into December, the IRS could be forced to postpone the opening of the 2016 filing season. This would delay the start of processing of tax refunds for millions of taxpayers. In order to ensure there are no disruptions to the upcoming filing season, we believe it is critical for Congress to make a decision on the extenders legislation no later than the end of November. It will also be important to know whether any such legislation will be passed with or without substantive changes to the tax provisions. Minimal

changes to the provisions will simplify changes to IRS systems and aid the IRS in starting the tax filing season on time.

In addition to its efforts on tax extenders, the Committee has also been considering identity theft legislation. This legislation contains a number of provisions that would assist the IRS in its fight against stolen identity refund fraud and also improve tax administration generally. They include:

- ***Acceleration of information return filing due dates.*** Under current law, most information returns, including Forms 1099 and 1098, must be filed with the IRS by February 28 of the year following the year for which the information is being reported, while Form W-2 must be filed with the Social Security Administration (SSA) by the last day of February. The due date for filing information returns with the IRS or SSA is generally extended until March 31 if the returns are filed electronically. The proposed legislation would require these information returns to be filed earlier, which would assist the IRS in identifying fraudulent returns and reduce refund fraud, including refund fraud related to identity theft.

- ***Authority to require minimum qualifications for return preparers.*** The proposed legislation would provide the agency with explicit authority to require all paid preparers to have a minimum knowledge of the tax code. Requiring all paid preparers to keep up with changes in the Code would help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. It would help the IRS to focus resources on the truly fraudulent returns.

- ***Expanded access to National Directory of New Hires***. Under current law, the IRS is permitted to access the Department of Health and Human Services' National Directory of New Hires for purposes of enforcing the Earned Income Tax Credit and verifying employment reported on a tax return. The proposed legislation would allow IRS access to the directory for broader tax administration purposes, which would assist the agency in preventing stolen identity refund fraud.

- ***Masking Social Security Numbers (SSN).*** Under current law, the Form W-2 furnished to an employee must include the employee's SSN. The proposed legislation would allow truncated SSNs on the copy of the Form W-2 furnished to employees. This change would make it more difficult for identity thieves to steal SSNs.

- ***Streamlined critical pay authority.*** The IRS Restructuring and Reform Act of 1998 increased the IRS's ability to recruit and retain a small number of key executive-level staff by providing the agency with streamlined critical pay authority. This allowed the IRS, with approval from Treasury, to

hire well-qualified individuals to fill positions deemed critical to the agency's success in areas such as international tax, IT, cybersecurity, online services and analytics support. This authority, which ran effectively for 14 years, expired at the end of Fiscal Year (FY) 2013. The loss of streamlined critical pay authority has created major challenges to our ability to retain employees with the necessary high-caliber expertise in the areas mentioned above. The proposed legislation would reinstate this authority.

The IRS has also discussed with the Committee a number of other proposals that would improve tax administration, and I encourage the Committee to approve these provisions as well. They include:

- ***Correctible error authority.*** The IRS has authority in limited circumstances to identify certain computation mistakes or other irregularities on returns and automatically adjust the return for a taxpayer, colloquially known as "math error authority." At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific, newly enacted tax code amendments. The IRS would be able to significantly improve tax administration – including reducing improper payments and cutting down on the need for costly audits – if Congress were to enact a proposal contained in the President's FY 2016 budget request to replace the existing specific grants of this authority with more general authority covering computation errors and incorrect use of IRS tables. Congress could also help in this regard by creating a new category of "correctible errors," allowing the IRS to fix errors where the IRS has reliable information that a taxpayer has an error on his/her return.

- ***Simplification of partnership audits***. Auditing of large partnerships has become very challenging for the IRS, in part because of the way the agency must apply the partnership audit rules contained in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). These rules were designed to improve tax administration by making it possible for the IRS to conduct audits at the partnership level, instead of auditing each individual partner. But TEFRA was enacted when partnerships generally were smaller than they are today, and before they had complicated tiered structures as they do now. The TEFRA rules generally require the IRS to notify each partner at the start of an audit and to push any resulting adjustment down through the partnership to each partner. Thus, a single audit can generate thousands of adjustments. One proposal that has been offered by the Administration would mandate certain streamlined audit and adjustment procedures for any partnership that has 100 or more direct partners, or that has at least one direct partner that is a pass-through entity. Under the streamlined procedures, only direct partners would receive audit adjustments, and any direct partner that was itself a pass-through entity would be responsible for paying the resulting tax.

Chairman Hatch, Ranking Member Wyden and Members of the Committee, this concludes my testimony. I would be happy to take your questions.

**Public Comments on Key Issues for Guidance for Tax-Exempt Organizations on Political Campaign Intervention (REG-134417-13)**
**10/27/15**

In a May 2013 report, the Treasury Inspector General for Tax Administration (TIGTA) noted that one cause of the substantial delays in processing applications for tax-exempt status, including applications potentially involving significant political campaign intervention, was confusion due to the lack of specific guidance on how to determine whether the promotion of social welfare is the "primary" activity of a section 501(c)(4) organization. As a first step in providing such guidance, the Treasury Department and the IRS published a notice of proposed rulemaking in the Federal Register in November 2013 (2013 proposed regulations). That proposal, regarding section 501(c)(4) organizations, identified political activities related to candidates that would not be considered to promote social welfare. More than 160,000 written comments were received in response to the 2013 proposed regulations.

This document provides an overview of public comments received on three key and interrelated issues on which the Treasury Department and the IRS solicited public comment in the 2013 proposed regulations:

(1) Whether to retain or modify the "primarily" standard under section 501(c)(4);
(2) The appropriate scope of the definition of nonexempt political campaign activity under section 501(c)(4); and
(3) The potential application of a uniform definition of political campaign intervention to all section 501(c) tax-exempt organizations.

It is important to note that this overview does not cover all of the comments received or all of the potential issues being considered. Any future guidance on these issues will be introduced in the form of proposed regulations to provide the public with ample, additional opportunity to provide input, both in the form of written comments and at a future public hearing.

## Retention or Modification of the "Primarily" Standard Under Section 501(c)(4)

The exemption from federal income tax provided in section 501(c)(4) to "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare" dates back to the enactment of the federal income tax in 1913. For over 55 years, the current section 501(c)(4) regulations have provided that an organization is "operated exclusively" for the promotion of social welfare within the meaning of section 501(c)(4) if it is "primarily engaged" in promoting in some way the common good and general welfare of the people of the community. Under the 1959 regulations, a section 501(c)(4) organization may engage in some political campaign intervention, so long as the organization is operated primarily for the promotion of social welfare. This "primarily" standard applies to all section 501(c)(4) organizations, including the numerous section 501(c)(4) organizations that do not engage in political campaign intervention but, for example, may engage in other nonexempt activities, such as facilitating social activities for the benefit, pleasure, or recreation of its members, or engaging in some unrelated business activity. Given the potential impact of any change in the "primarily" standard on the tax status of organizations currently described in section

501(c)(4), the Treasury Department and the IRS solicited comments from the public on what proportion of an organization's activities must promote social welfare for an organization to qualify under section 501(c)(4) and whether additional limits should be imposed on any or all activities that do not further social welfare. The Treasury Department and the IRS also requested comments on how to measure the activities of organizations seeking to qualify as section 501(c)(4) organizations for these purposes.

Over 3,000 commenters expressed opinions regarding whether the "primarily" standard should be retained or modified. Many of these commenters generally supported retention of the current "primarily" standard, which some interpreted as allowing up to 49 percent of an organization's activities to further nonexempt purposes. Some of the commenters who supported retention of the current "primarily" standard expressed the view that there is no reason or justification for adopting a more narrow regulatory standard because, unlike section 501(c)(3) organizations, section 501(c)(4) organizations are not subject to a statutory prohibition on political campaign intervention activities and cannot receive tax-deductible contributions.

Other commenters suggested more restrictive standards. Some commenters suggested restricting section 501(c)(4) organizations to insubstantial amounts of nonexempt activity, with several suggesting that such a standard would more closely mirror the limit Congress has imposed on lobbying activities by section 501(c)(3) organizations. Numerous commenters supported replacing the "primarily" standard with a strict interpretation of "exclusively," emphasizing the statutory language of section 501(c)(4) requiring such organizations to be operated "exclusively" for the promotion of social welfare. Several of these commenters maintained that adopting a strict "exclusively" standard would substantially reduce the need for fact-intensive analysis; that is, although the IRS would still need to determine whether a specific activity constitutes nonexempt political activity, the need for fact-intensive analysis to determine the amount of such activity would be minimized. However, other commenters noted that defining "exclusively" under section 501(c)(4) to allow no or only *de minimis* nonexempt activity would effectively ban political campaign intervention under section 501(c)(4) through regulations alone, whereas the ban on political campaign intervention under section 501(c)(3) is statutory. Moreover, a few commenters noted that the adoption of a strict interpretation of "exclusively" could disrupt existing section 501(c)(4) organizations that do not engage in political campaign intervention but do, for example, engage in nonexempt business or social activities.

Finally, some commenters advocated for guidance that would provide a clear percentage limit on either nonexempt activity generally or political campaign intervention activities specifically, although the suggested limits varied widely, ranging from two percent up to 49.9 percent.

Measurement of the Chosen Standard Under Section 501(c)(4)

A question related to the amount of social welfare activity in which a section 501(c)(4) organization must engage is how activities of an organization should be measured under the standard that is chosen. Most commenters expressing a view on how to measure activities of organizations seeking to qualify as section 501(c)(4) organizations supported measuring an organization's activities in terms of its

expenditures. Some commenters expressly opposed the inclusion of volunteer hours in the measurement of an organization's activities, emphasizing the lack of guidance regarding how to count, allocate, and quantify volunteer hours as well as the burden placed on organizations, particularly those with thousands of volunteers, to track volunteer hours in light of this uncertainty.

Interaction of the Chosen Standard Under Section 501(c)(4) with Section 527

Despite their varied views, commenters tended to agree that the appropriate amount of nonexempt activity in which a section 501(c)(4) organization may engage is also informed by Congress' later enactment of section 527. Congress enacted section 527 in 1975 to govern the tax treatment of political organizations "primarily" engaged in accepting contributions or making expenditures for activities that influence or attempt to influence elections, as well as appointments and nominations, to public office. In addition, Congress expressly acknowledged in the legislative history accompanying enactment of section 527 that certain tax-exempt organizations, including section 501(c)(4) organizations, may engage in some political campaign activities.[1] The statute taxes such activity through section 527(f), which imposes a tax on the lesser of a section 501(c) organization's aggregate expenditures during any taxable year for a section 527 exempt function or its net investment income in that taxable year. The statute also permits a tax-exempt organization to avoid application of the section 527(f) tax by establishing a separate segregated fund that is treated as a section 527 political organization (and, therefore, subject to the notice and reporting requirements imposed by sections 527(i) and (j) on section 527 organizations generally in amendments enacted in 2000 and 2002).

The availability of separate segregated funds was emphasized by commenters who suggested the more restrictive standards of either mirroring the "no substantial part" limit on lobbying activities in section 501(c)(3) or strictly interpreting "exclusively" under section 501(c)(4), as these separate segregated funds would provide a transparent vehicle through which a section 501(c)(4) organization may engage in political campaign activity without jeopardizing its tax-exempt status. However, other commenters argued that Congress ratified the "primarily" standard under section 501(c)(4) in enacting section 527; that is, Congress chose to address substantial political activity by section 501(c)(4) organizations by imposing the section 527(f) tax on section 527 exempt function activities by such organizations, rather than by amending the existing "primarily" standard under the 1959 regulations.

**Scope of the Definition of Nonexempt Political Campaign Activity Under Section 501(c)(4)**

Over the years, the IRS has stated that whether an organization is engaged in political campaign intervention depends upon all of the facts and circumstances of each case. The Treasury Department and the IRS recognize that more definitive rules with respect to political activities relating to candidates – rather than the existing fact-intensive

[1] S. Rept. No. 93-1357, 93d Cong., 2d Sess. (December 16, 1974), at 29.

analysis – would be helpful in applying the rules regarding qualification for tax-exempt status under section 501(c)(4). Therefore, the 2013 proposed regulations provided a specific definition of candidate-related political activity, and proposed to expand the definition of "candidate" to include individuals seeking appointment or nomination to public office as a way to link the definition of nonexempt political activity under section 501(c) with section 527's broader exempt function. As discussed further in this section, many commenters objected to this proposed approach. Instead, those commenters supported a more limited definition of nonexempt political campaign activity under section 501(c)(4) that would exclude activities related to nominees or appointees for public office, and that would exclude issue advocacy and voter education and outreach activities conducted in a nonpartisan manner and grants to section 501(c) organizations for non-political purposes.

Definition of "Candidate"

Traditionally, the scope of political campaign intervention under section 501(c) has been limited to intervention in campaigns for elective public office. In defining nonexempt candidate-related political activity for purposes of section 501(c)(4), the 2013 proposed regulations would have expanded the definition of "candidate" beyond an individual who publicly offers himself, or is proposed by another, for elective public office to encompass the appointment or confirmation of executive branch officials and judicial nominees (as well as the selection of officers in a political organization, among others). In this way, the definition of candidate-related political activity in the 2013 proposed regulations reflected the broader scope of section 527 (and the activities to which Congress intended the section 527(f) tax to apply).

Commenters almost universally recognized the difficulty in reconciling section 527's broad definition of exempt function, which includes activities related to elections, appointments, and nominations to public office, with political campaign intervention under section 501(c), which traditionally has described only activities related to campaigns for elective public office. Yet, of the more than 200 commenters specifically addressing the scope of "candidate," the majority generally opposed the proposed inclusion of individuals who are proposed as nominees or appointees for public office in the definition of candidate-related political activity as the means by which to reconcile these two standards. Some of these commenters noted that the IRS historically has treated a section 501(c)(3) organization's support for, or opposition to, Senate confirmation of a nominee as permissible (albeit restricted) lobbying activity, and therefore reason that section 501(c)(4) organizations should be accorded the same treatment. See Notice 88-76 (1988-2 CB 392) (holding that attempts to influence the Senate's confirmation of a federal judicial nominee did not constitute political campaign intervention for purposes of section 501(c)(3)). Some commenters emphasized the fundamental distinction between appointive positions and elective offices, noting that the decision of legislators to confirm or deny a nominee is more akin to a vote on proposed legislation than to the decision of voters in an election. Additional commenters expressed concern that restricting the lobbying activities of section 501(c)(4) organizations in this manner would constitute an unconstitutional restriction of free speech, both for section 501(c)(4) organizations as well as for section 501(c)(3) organizations engaged in lobbying activities through a section 501(c)(4) affiliate, as contemplated in Regan v. Taxation with Representation, 461 U.S. 540 (1983). Other commenters argued that, if Congress had intended the term

"candidate" within the context of section 501(c) to include nominees and appointees, Congress could have amended section 501(c)(3) in 1975 when it enacted section 527.

Issue Advocacy

The proximity of a communication about a candidate to the election in which that candidate seeks office has long been a factor tending to indicate that the communication is political campaign intervention under section 501(c) and/or section 527 exempt function activity. See Rev. Rul. 2007-41 and Rev. Rul. 2004-6. Accordingly, the 2013 proposed regulations provided that candidate-related political activity would include any public communication within 30 days of a primary election or 60 days of a general election that refers to one or more clearly identified candidates in that election or, in the case of a general election, refers to one or more political parties represented in that election. In the preamble to the 2013 proposed regulations, the Treasury Department and the IRS explained that the proposed regulations drew from provisions of federal election campaign laws that treat certain communications that are close in time to an election and that refer to a clearly identified candidate as electioneering communications. In addition, the Treasury Department and the IRS noted that the proposed approach would avoid the need to consider potential mitigating or aggravating circumstances in particular cases (such as whether an issue-oriented communication is "neutral" or "biased" with respect to a candidate). The Treasury Department and the IRS requested comments on whether there are particular communications that (regardless of timing) should be excluded from the definition of candidate-related political activity because they can be presumed to neither influence nor constitute an attempt to influence the outcome of an election and stated that any comments should specifically address how the proposed exclusion is consistent with the goal of providing clear rules that avoid fact-intensive determinations.

Many commenters expressed concern that the proposed provision would inappropriately capture, for a substantial portion of any year in which federal and state elections occur, routine legislative and issue advocacy, grassroots lobbying, and communications to or about public officials, including old publications on the Internet, educational materials, and news gathering and reporting – communications and activities traditionally permitted under section 501(c)(4). In addition, numerous commenters expressed concern that the proposed provision would limit the ability of section 501(c)(4) organizations to educate the public or comment on key policy issues during the period in which citizens are most engaged and public officials are most responsive.

Commenters also generally emphasized that any timeframes necessarily are arbitrary, in that the same communication may be considered candidate-related political activity on day 30 or 60, but not on day 31 or 61. Commenters also emphasized that timeframes are both over- and under-inclusive, in that they would be ineffective at limiting politically motivated communications prior to the relevant pre-election period, while simultaneously limiting the ability of groups to do legitimate policy advocacy inside it. Some commenters stated that the proposed provision would inappropriately expand the existing election law concept of "electioneering communication" from which the timeframes are drawn – a concept limited to broadcast, cable, or satellite communications that are directed at more than 50,000 persons in the relevant electorate. Other commenters emphasized that the proposed approach of defining public communication

as any communication directed at 500 persons (rather than 50,000 persons in the relevant electorate) would inappropriately capture emails to internal listservs and other communications with members who actively and affirmatively ask to receive information or to be associated with an organization, thereby failing to distinguish such communications from, for example, a mass media advertisement aired during a large, televised sporting event that is aimed at members of the general public who have no say in whether they receive it. A few commenters expressed the concern that application of the timeframes to state and local elections, in addition to the federal elections already regulated by the FEC, would greatly increase the complexity of tracking the timeframes and candidates potentially subject to the rule.

Some commenters supported the approach of the proposed regulations, with a few commenters positing that communications directed to the general public that mention the name of a candidate close in time to an election are in fact motivated by electoral politics. A few commenters argued that the proposed provision is supported by the IRS's (and the public's) interest in clarity and precision in standards for determining tax-exempt status, and noted that expenditures for candidate-related communications close in time to an election could be made by a section 527 affiliate or a separate segregated fund subject to the section 527(j) reporting provisions.

Regardless of whether they opposed or supported the proposed provision, some commenters suggested exceptions for certain types of communications, in particular for issue advocacy, in the event that a rule treating candidate-related communications made during a specified timeframe (in addition to those containing express advocacy) as nonexempt political campaign activity is retained.

Voter Education and Outreach Activity

The 2013 proposed regulations would have defined candidate-related political activity to include certain specified election-related activities, such as the conduct of any voter registration or get-out-the-vote drive; the preparation or distribution of any voter guide that refers to one or more clearly identified candidates or, in the case of a general election, to one or more political parties (including material accompanying the voter guide); and hosting or conducting an event within 30 days of a primary election or 60 days of a general election at which one or more candidates in such election appear as part of the program. In acknowledgement that these proposed provisions may capture activities conducted in a nonpartisan and unbiased manner, the Treasury Department and the IRS requested comments on whether any particular election-related activities should be excepted from the definition of candidate-related political activity as voter education activity. If so, the Treasury Department and the IRS requested a description of how the proposed exception would both ensure that excepted activities are conducted in a nonpartisan and unbiased manner and still avoid a fact-intensive analysis.

Commenters overwhelmingly opposed the proposed inclusion of voter education and outreach activities in the definition of candidate-related political activity without regard to whether such activities are conducted in a partisan or nonpartisan manner. More than 20,000 commenters stated that classifying nonpartisan voter education and outreach activity in this manner would have an adverse effect on section 501(c)(4) organizations. Many commenters stated that such activities promote social welfare, reasoning that

nonpartisan voter education and outreach encourages civic participation and educates and engages the voting public. Furthermore, commenters asserted that nonpartisan voter registration and get-out-the-vote drives, voter guides, and candidate events are constitutionally protected activities, and that burdening such activities raises First Amendment concerns.

Grantmaking to Other Section 501(c) Organizations

The 2013 proposed regulations would have defined candidate-related political activity to include a contribution to any organization described in section 501(c) that engages in candidate-related political activity (within the meaning of the 2013 proposed regulations), unless accompanied by a written representation that the recipient does not engage in any such activity and made subject to a written restriction preventing the use of the contribution for such activity.

Many commenters opposed the proposed approach to contributions. Some commenters stated that a contribution should not be considered candidate-related political activity if it is simply earmarked for non-political purposes. Other commenters argued that the proposed provision, combined with the already broad definition of candidate-related political activity, would unduly limit the ability of section 501(c)(4) organizations to promote social welfare through grantmaking and particularly disadvantage section 501(c)(3) organizations that rely on section 501(c)(4) organizations for funding, as their section 501(c)(3) activities may be irreconcilable with, for example, the inclusion of all voter registration drives within the broad proposed definition of candidate-related political activity. In addition, many commenters specifically opposed any need for a good-faith, written representation that the recipient organization does not engage in candidate-related political activity, reasoning that recipient section 501(c) organizations would be reluctant to make this certification because recipients may not want to restrict their future activities. Finally, many commenters expressed concern that, under the proposed provision, the full amount of a contribution would be considered candidate-related political activity, regardless of how little candidate-related political activity the recipient organization engages in.

On the other hand, many commenters supported the proposed provision, reasoning that it is reasonable to presume that a section 501(c) organization that engages in campaign-related spending would use contributions for that purpose. Some of these commenters expressed concern in particular about the "increasingly prevalent use" of grants by section 501(c)(4) organizations to other section 501(c) organizations for "general support" that the grantor claims as social welfare expenditures. These commenters stated that such grants enable the recipient organization, in turn, to pass along the grant to another section 501(c) organization and/or expend some (or all) of the grant on political campaign activity. As evidence of such transfers, a few commenters noted that recipients of general support grants from section 501(c)(4) organizations have reported millions in campaign spending to the FEC.

**Potential Application of a Uniform Definition of Political Campaign Intervention Across Section 501(c)**

In the preamble to the 2013 proposed regulations, the Treasury Department and

the IRS solicited comments regarding whether the same or similar approach to defining candidate-related political activity under section 501(c)(4) should be adopted in addressing the nonexempt political campaign activities of other section 501(c) organizations. The Treasury Department and the IRS noted with respect to section 501(c)(3) charitable organizations, 501(c)(5) labor organizations, and 501(c)(6) business leagues in particular that any change would be introduced in the form of proposed regulations to allow an additional opportunity for public comment.

Several commenters expressed the opinion that political campaign activity by section 501(c)(4), 501(c)(5), or 501(c)(6) organizations should be an exempt activity, given the absence of an express statutory prohibition on such activities (as exists in section 501(c)(3)). In the context of section 501(c)(4), several commenters reasoned that any political campaign activity should be considered to promote social welfare because, in a democracy, it is difficult to promote "civic betterment and social improvements" or effectuate changes in public policy without promoting the election of like-minded candidates. In the context of section 501(c)(5) and 501(c)(6) organizations, a few commenters similarly noted that these organizations' unique exempt purposes of furthering the shared labor or business interests of their members and industry may be best supported through the election of legislators that will further those interests.

More than 7,000 commenters expressed general opposition to the 2013 proposed regulations because those regulations did not apply to other tax-exempt organizations, such as section 501(c)(5) and 501(c)(6) organizations, reasoning that such an approach is inequitable. Approximately 2,500 commenters expressed general support for defining nonexempt political campaign activity by section 501(c)(4) organizations and stated that any such definition, although not necessarily the definition of "candidate-related political activity" in the 2013 proposed regulations, should apply to other tax-exempt organizations as well. Such commenters argued that section 501(c)(4), 501(c)(5), and 501(c)(6) organizations are often prominent and competing players in the same advocacy space, such that application of the definition of candidate-related political activity to section 501(c)(4) organizations alone would create an uneven political playing field and encourage the shifting of funds toward section 501(c)(5) and 501(c)(6) organizations.

Some commenters who support adopting the same or similar approach to defining nonexempt political activities across section 501(c)(4), 501(c)(5), and 501(c)(6) expressed more hesitation with respect to a uniform standard across section 501(c)(3) and 501(c)(4), reasoning that the statutory prohibition on political campaign intervention activities by section 501(c)(3) organizations indicates that additional modifications to the definition of nonexempt political activity may be necessary to exclude historically-permissible issue advocacy and voter education and outreach activities conducted in a nonpartisan manner – modifications also suggested with respect to any definition of nonexempt political campaign activity applicable under section 501(c)(4) alone. Other commenters, however, emphasized the potential burden that different definitions would impose on section 501(c)(3) organizations with section 501(c)(4) affiliates that may share staff, office space, and other resources, as these organizations would need to train their staff to understand the distinctions between the traditional facts-and-circumstances inquiry that would still apply under section 501(c)(3) and the definition of candidate-related political activity in the 2013 proposed regulations that would apply under section 501(c)(4) in order to accurately

classify and track their time and activities. Moreover, commenters argued that applying different definitions may have a chilling effect on speech because, for example, section 501(c)(3) organizations may be reluctant to engage in activities that would be considered candidate-related political activity if conducted by a section 501(c)(4) affiliate, even if those activities are permitted under section 501(c)(3). Commenters cautioned that the potential confusion caused by multiple standards and this chilling effect would be more acute for small or mid-sized section 501(c)(3) organizations that may not have the means to retain legal counsel.

Additional commenters suggested that the enactment of section 527 supports the application of a uniform definition of nonexempt political campaign activity across section 501(c). Commenters asserted that every category of section 501(c) organization potentially is subject to the section 527(f) tax, indicating that section 527 exempt function activities (which include efforts to influence both electoral and non-electoral selection events) do not constitute tax-exempt activity when conducted by an organization other than a section 527 political organization (which includes a section 527(f)(3) separate segregated fund established by a section 501(c) organization). These commenters suggested applying a single definition of political campaign intervention (limited to attempts to influence campaigns for elective public office) across section 501(c) and addressing the interaction with the section 527(f) tax by clarifying that the section 527(f) tax would apply to (among other expenditures) any expenditures for political campaign intervention as defined for purposes of section 501(c).

## Conclusion

This information is provided to the Committee to give insight into the range of comments received on a few of the key issues under consideration. We continue to consider all the comments received on these and other issues.

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

COMMISSIONER

September 10, 2015

The Honorable Orrin G. Hatch
The Honorable Ron Wyden
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman and Ranking Member:

Thank you for your Committee's bipartisan report on its investigation into the IRS's processing of section 501(c)(3) and section 501(c)(4) applications for tax-exempt status submitted from 2010-2013 by organizations seeking to engage in political advocacy.

As I have testified, I believe that oversight is a critically important management tool. The bipartisan report reflects the depth and seriousness of this exercise of your Congressional oversight authority, as well as the enormous amount of hard work and time spent by your Committee and staff on the investigation. By its thorough and detailed nature, the report provides the definitive account of the IRS's section 501(c)(4) processing issues.

The IRS will implement all of the report's findings and recommendations within its control. I am enclosing a responsive report that describes the actions the IRS has taken, and will continue to take, that relate to each recommendation. In some cases, these actions have already produced positive results. For example, as a result of several new initiatives, the IRS has dramatically reduced the inventory of tax-exempt organization applications aged 270 days or older from 32,713 applications in April 2014, to 487 applications as of August 2015. The IRS will continue its efforts to further reduce or eliminate the remaining over-age inventory, while also working towards achieving similar improvements with respect to the other problems identified in the report.

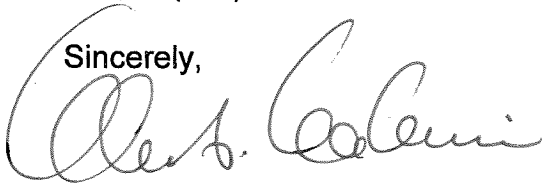
Another issue to note is the IRS's progress in ensuring that electronic media containing important records are preserved and protected. In the last year, the IRS has taken significant measures in this regard and is incorporating learnings from past events. While investigating the degaussing of disaster recovery tapes, the Treasury Inspector General for Tax Administration (TIGTA) uncovered "no evidence that the IRS employees involved intended to destroy data on the tapes or hard drives in order to keep this information from the Congress, the DOJ or TIGTA." (TIGTA, Exempt Organization Data Loss, Report of Investigation, 54-1406-008-1, June 30, 2015 (reproduced at page 4041 *et seq.* of the Report Appendix)). However, the IRS's failure to ensure complete implementation of its litigation hold is clearly unacceptable. With the

benefit of TIGTA's report, which meticulously documents the communications breakdown among our records management personnel in March of 2014, the IRS is implementing records management improvements. Specifically, we have initiated a process to secure the email records of all senior officials in the agency, including having all files archived to the network rather than on individual hard drives. We are also implementing a plan to preserve official records based on recommendations from a study conducted by the National Archives and Records Administration (NARA). In addition, we have taken significant measures to increase training of front-line IT employees on document preservation issues, to exert greater control over the management of our email server backups, and to continue the preservation of all disaster recovery tapes. Collectively, these steps have helped the IRS create better policies and procedures to ensure this incident will not happen again.

I hope the information in the enclosed report is helpful, and that the actions described in this report demonstrate the IRS's commitment to address and fix the problems with its processing of tax-exempt applications. As I have testified on several occasions, the problems confronting organizations seeking to become social welfare organizations should never have happened and we have apologized for the difficulties experienced. We are dedicated to doing everything we can to ensure the public has confidence that every taxpayer will be treated fairly and in an unbiased manner by the IRS, no matter what their political or religious beliefs, who they voted for in the last election, or which organizations they belong to or support. The IRS looks forward to seeing its actions in this area translate into top quality service for America's exempt organizations.

If you have any questions, please contact me or have your staff contact Leonard Oursler, Director, Legislative Affairs, at (202) 317-6985.

Sincerely,



John A. Koskinen

Enclosure


# Internal Revenue Service Report Response to:

# The Senate Finance Committee's Report on the processing of sections 501(c)(3) and 501(c)(4) applications for tax-exempt status submitted by "political advocacy" organizations from 2010-2013 (114-119) (August 5, 2015)

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September 10, 2015

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## Introduction

On May 20, 2013, the Senate Finance Committee initiated a bipartisan investigation into allegations of potential targeting of certain tax-exempt organizations by the Internal Revenue Service. On August 5, 2015, the Finance Committee released a thorough and detailed bipartisan report on the IRS's processing of section 501(c)(3) and section 501(c)(4) applications for tax-exempt status submitted by "political advocacy" organizations from 2010-2013. The Finance Committee Report contains a number of specific and focused bipartisan findings and related bipartisan recommendations. The Report also contains additional recommendations prepared by the Majority and Minority staffs. The IRS plans to implement each and every one of the Report's bipartisan findings and recommendations within its control, as well as all the recommendations prepared by both the Majority and Minority staffs.[1]

Prior to the Finance Committee initiating its investigation, the Treasury Inspector General for Tax Administration, in May 2013, released its report (2013 TIGTA Report) on the IRS's processing of applications for tax-exempt status.[2] The TIGTA report described numerous problems associated with the IRS's process for determining applicants' tax-exempt status.

In response to the many questions posed by the Finance Committee during its investigation and the recommendations in the 2013 TIGTA Report, the IRS took significant actions to address the problems identified. Due to the interrelatedness of the Finance Committee and TIGTA recommendations, rather than addressing each recommendation in numeric order, the framework of this report is organized topically based on the main concerns of the findings and related recommendations, as follows:

1. Promoting Transparency and Accessibility in the Exempt Organization Determination Process
2. Streamlining the Exempt Organizations Determination Process to Ensure Timely Processing and Reduce Delay
3. Realigning Organizational Functions for Improved Service
4. Fostering a Culture of Accountability
5. Strengthening Risk Management through Improved Communication
6. Bolstering Employee Training
7. Ensuring Neutral Review Processes
8. Reviewing the Use of the Office Communicator System
9. Improving Procedures under the Freedom of Information Act (FOIA)

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[1] The IRS also plans to address several implicit findings and recommendations contained in the Finance Committee Report.

[2] "Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review," TIGTA Audit Report No. 2013-10-053 (May 13, 2013); see also "Status of Actions Taken to Improve the Processing of Tax-Exempt Applications Involving Political Campaign Intervention" (Reference Number: 2015-10-025) (March 27, 2015). The IRS continues to respond to the TIGTA Report, as well as to two reports of the GAO. "Tax-Exempt Organizations: Better Compliance Indicators and Data, and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations" (GAO-15-164) (December 2014); "IRS Examination Selection Internal Controls for Exempt Organization Selection Should Be Strengthened" (GAO-15-514) (July 2015).

10. Responding to Government Accountability Office Recommendations
11. Recommendations outside IRS Jurisdiction or that Require Legislative Changes

This report describes IRS actions in each of these areas that are either completed or already underway, and identifies areas for ongoing progress and improvement. These steps started in the summer of 2013 and continue today. Highlights of the IRS's structural, substantive, and corrective actions include: (1) installing a new management team in the Tax Exempt/Government Entities (TE/GE) Division; (2) developing new training programs and conducting workshops on critical issues, including the difference between issue advocacy and political campaign intervention, and the proper way to identify applications that require review of political campaign intervention activities; (3) issuing guidelines for Exempt Organizations (EO) specialists on how to process requests for tax-exempt status involving potentially significant political campaign intervention; (4) creating a formal, documented process for EO Determinations personnel to request assistance from technical experts; and (5) reducing the over-age case inventory of EO Determinations applications by over 98% from April 2014. The IRS is also committed to following through on key initiatives, such as continuing its thorough review and consideration of over 160,000 public comments and suggestions for the development of clear, fair, and easy-to-administer guidance relating to the measurement of political campaign activities under section 501(c)(4), and taking further responsive actions, as necessary.

## Promoting Transparency and Accessibility in the Exempt Organizations Determination Process[3]

Some of the Finance Committee's recommendations raise concerns regarding transparency in the EO determination process. The IRS is committed to increasing transparency and accessibility to generate more public trust in the process. Since the release of the 2013 TIGTA Report, the EO function has made significant progress in facilitating public access to relevant materials through substantive updates to the Internal Revenue Manual (IRM) sections[4] and revenue procedures[5] that relate to the application process. These resources continue to be available to the public via the IRS website.[6] The EO function has also made new tools available to exempt organizations, including the online, interactive Form 1023i.[7] Moving forward, the EO function will review the current instructions for Form 1023 and Form 1024 to determine whether references to any of the resources available on the IRS's website need to be added. If additional references are needed, the IRS will ensure that all such references are included when the instructions to the forms are updated in Fiscal Year (FY) 2016.

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[3] This discussion relates to the Finance Committee's bipartisan Finding #1 and the related bipartisan Recommendation #1. See Appendix A, Finding B1, Recommendation B1.1.
[4] IRM 7.1.2, 7.20.1, 7.20.2, 7.20.3, 7.20.6.
[5] Rev. Proc. 2015-4, 2015-5, 2015-8, 2015-9, 2015-10, and 2014-11.
[6] www.irs.gov/Charities-&-Non-Profits/Applying-for-Tax-Exempt-Status.
[7] www.irs.gov/Charities-&-Non-Profits/Applying-for-Tax-Exempt-Status.

## Streamlining the Exempt Organizations Determination Process to Ensure Timely Processing and Reduce Delay[8]

Several of the Finance Committee Report's findings and recommendations center on improving the timeliness of the EO determination process. The EO function is committed to resolving all determination cases within 270 days. Overall, actions taken by the IRS to reduce cycle times and eliminate the application backlog, since the beginning of the Finance Committee's investigation, have proven extremely successful. In 2014, the EO function modified its internal processes and began tracking cases once they became 90 days-old to ensure that potential barriers to resolution were identified and addressed early on. Additionally, the EO function works proactively with tax-exempt organizations on their applications even though, in some instances, doing so may result in longer processing times.

In FY 2014, the EO function conducted a thorough review of workflow processes, aimed at reducing cycle times and eliminating a significant backlog of applications. As a result of this review, the EO function modified several case processing procedures for all applications, including those with potential political campaign intervention activities. For instance, the EO function adopted "Streamlined Case Processing"[9] and introduced Form 1023-EZ to simplify the process for smaller applicants.[10] These actions complemented measures already adopted in response to the 2013 TIGTA Report, including the "Optional Expedited Process" for 501(c)(4) organizations with potential political campaign intervention activities. In fact, this new process was so effective that TIGTA recently recommended expanding to section 501(c)(5) and section 501(c)(6) applicants.[11][12]

The EO function also focused on revising procedures for technical assistance requests, which must be completed within established timeframes.[13] In 2013, for example, the EO function initiated a new procedure pursuant to which specialists have 60 days to complete responsive

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[8] This discussion relates to bipartisan Finding #2 and the related bipartisan Recommendations, as well as bipartisan Finding #3 and the related Recommendation #2. See Appendix A, Finding B2, Recommendations B2.1, B2.2, & B2.3; Finding B3, Recommendation B3.2. It also relates to Majority Recommendation #4, p. 267. See Appendix A, Recommendation Maj4.

[9] Interim Guidance Memorandum, TE/GE-07-0315-0006 (March 12, 2015).

[10] Per the 1023 EZ eligibility worksheet, smaller organizations are defined as ones (1) not having gross receipts exceeding $50,000 in any of the past 3 years and (2) with total assets not exceeding $250,000. Additionally, a Lean Six Sigma study in 2013 for purposes of improving the efficiency of the EO Determination process led to the ultimate creation of the EZ form. See http://www.irs.gov/pub/irs-pdf/i1023ez.pdf.

[11] Status of Actions Taken to Improve the Processing of Tax-Exempt Applications Involving Political Campaign Intervention," TIGTA Ref. No. 2015-10-025 (March 27, 2015), p.16.

[12] This discussion relates Minority Recommendation #3, p. 314. See Appendix A, Recommendation Min12.

[13] These new procedures were developed in response to a recommendation contained in the 2013 TIGTA Report. Interim Guidance Memorandum, TE/GE-07-0713-11 (July 15, 2013); incorporated into IRM 7.1.2 (9-22-14).

memorandums. In 2015, when TIGTA conducted a follow-up audit of these new procedures, it found that the EO Technical Unit exceeded this goal by providing responses within 40 days.[14]

These process changes have proven effective in improving timeliness and reducing inventory. From April 2014 to July 2015, applications submitted on Forms 1023 (which make up the majority of the EO Determinations inventory) dropped from an average age of 256 days to 107 days, while applications submitted on Forms 1024 went from 256 days to 112 days. For those cases that were 270 days or older, the EO function dramatically reduced its inventory from 32,713 applications as of April 2014 to 487 applications as of August 2015. Of the 487 remaining over-age cases, almost half are currently in "Group Suspense" status, meaning the EO function cannot take action, either because the cases are in litigation and under the jurisdiction of the Office of Chief Counsel or the Department of Justice, or because of taxpayer delays in responding to information requests.[15] The EO function will continue working toward further reducing or eliminating the remaining over-age inventory.

## Realigning Organizational Functions for Improved Service[16]

After 2013, the IRS evaluated whether current organizational structures and workplace locations were inhibiting performance. As a result of this evaluation, the IRS has made several notable structural changes aimed at enabling performance improvements.[17] For instance, the EO Director and the EO Director of Rulings & Agreements positions have been physically relocated from Washington, DC to Cincinnati, OH, so that the EO leadership is now physically co-located with most EO function employees working on determination applications. Additionally, as a result of Streamlined Case Processing and the introduction of the Form 1023-EZ, the efficiency in EO Determinations increased significantly. Therefore, after conducting a workload analysis, approximately 40 EO Determinations employees in El Monte, Sacramento, and Baltimore will be shifted to EO Examinations in October 2015. Not only does this realignment enable the EO function to provide much-needed resources to EO Examinations, it will also result in the majority of the remaining EO Determinations employees being co-located with their leadership in Cincinnati.

The Tax Exempt/Government Entities Division (TE/GE) also recognized the importance of timely and useful guidance from its legal counsel. To help achieve that result, in early 2015, TE/GE worked closely with the Office of Chief Counsel to realign functions that perform legal analysis, previously housed within TE/GE, to the Office of Chief Counsel. Additionally, the new stand-alone office of Tax Exempt and Government Entities Division Counsel in the Office of Chief Counsel was established, which now has responsibility for providing advice and

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[14] Status of Actions Taken to Improve the Processing of Tax-Exempt Applications Involving Political Campaign Intervention," TIGTA Ref. No. 2015-10-025 (March 27, 2015), p.13.
[15] When an organization does not respond to a request for additional information, EO follows the process contained in IRM 7.20.2. EO will give the organization time to respond to an initial letter, attempt to call the organization to secure a response, and in some instances give an extension of time to respond when requested by the organization.
[16] This discussion relates to bipartisan Finding #5 and the related bipartisan Recommendation. See Appendix A, Finding B5, Recommendation B5.1.
[17] See Appendix B, "Before and After Structures of the EO Division."

assistance on determinations, enforcement, and compliance issues to the TE/GE Division, which includes EO. As a result of these actions, there is now a clear separation of duties, as well as well-defined procedures and improved lines of communication between TE/GE leaders and their counterparts in the Office of Chief Counsel.

## Fostering a Culture of Accountability[18]

To support and enable a successful transition to the new organizational structure in the EO function, the IRS is ensuring that employees, managers, and leadership are engaged in an environment of accountability. Beginning in FY 2015, all TE/GE managers have a managerial commitment in their performance plans to conduct regular workload reviews with their direct reports. In EO, these workload reviews include a proactive inventory review by managers to ensure that employees are completing work in a timely fashion. While these reviews are initiated between the frontline managers and their employees, the case cycle time results and any other issues are shared with upper-level managers and executives in the EO Division and TE/GE through monthly Operational Reviews.

In addition to the workload reviews, managers in all TE/GE functions, including EO, conduct monthly Operational Reviews. These reviews ensure that managers are properly overseeing the work of their employees, regardless of the employees' place of duty or telework agreement. In 2014, TE/GE and EO leadership re-emphasized the need for managers in EO Determinations to conduct regular monthly meetings with employees to review over-age cases. Today, they continue to discuss the results of those inventory reviews with their Director. Cycle time information was, and continues to be, provided on a monthly basis to the EO Director and TE/GE Commissioner. Finally, cycle time data, including the number of over-age cases, are reported to the TE/GE Commissioner and the IRS Deputy Commissioner for Services and Enforcement quarterly, via the Business Performance Review process. The IRS Commissioner is informed of the number of over-age cases through regular updates provided every six weeks. As demonstrated by the data cited above, TE/GE leadership believes that the managerial commitment and focus on case processing oversight directly contributes to, and ensures, improved processing times and reduced inventory. If an employee or manager is not meeting performance timeliness standards, those issues will also be addressed through employee appraisals. The Critical Job Elements for TE/GE employees reference established IRM time frames for action. If employees fail to meet performance timeliness standards, management will address the issues in a manner consistent with the negotiated contract between IRS Management and the National Treasury Employees Union. Similarly, if managers fail to meet performance standards, senior management will address the issues in a manner consistent with the manager's performance agreement.

[18] This discussion relates to bipartisan Finding #2 and the related bipartisan Recommendations, as well as bipartisan Finding #3 and the related Recommendation #1. See Appendix A, Finding B2, Recommendations B2.1, B2.2, & B2.3; Finding B3, Recommendation B3.1.

## Strengthening Risk Management through Improved Communication[19]

Changes in processes and organization structure, along with a greater emphasis on more regular communication, have strengthened TE/GE's ability to manage risk effectively. More opportunities exist for interaction between managers and employees with the implementation of regular operational reviews, inventory reviews, and regular town hall meetings. Furthermore, a new Risk Management Process established in TE/GE this fiscal year as part of the IRS's development of an agency-wide risk management program beginning in FY 2014, is a mechanism that enables certain issues to be elevated from the group level to the executive leadership for review and discussion. This new and expansive process further mitigates the risk that sensitive issues may not be timely elevated within the organization.

During the Finance Committee's investigation, the EO function looked closely at its Sensitive Case Report (SCR) procedures. It has since made several revisions to strengthen the process to increase communication and mitigate potential risks. The EO function revised several IRM provisions to clarify the definitions of SCR issues, when and why to elevate issues, and the difference between elevating issues to inform managers and executives versus to obtain a decision. Issues are now elevated during monthly management updates, and SCRs are sent to executives who conduct a comprehensive review, ask necessary follow-up questions, request further briefings when appropriate, and determine potential next steps when needed.[20]

The TE/GE Division, including the EO function, is also in the process of implementing a new knowledge management process that will increase communication by disseminating information on technical topics. Core knowledge management teams will be made up of representatives from diverse backgrounds, such as determinations, examinations, and technical.

## Bolstering Employee Training[21]

Providing appropriate, current, and timely training for employees is essential to ensure revised processes and procedures are carried out as intended. Across the IRS, annual training expenditures were significantly reduced across the board between FY 2010 and FY 2014, as a result of ongoing cuts in the IRS budget. Nevertheless, following the release of the 2013 TIGTA Report, the EO function conducted substantial employee training. Today, the EO function puts a continuing emphasis on cost-effective training, and is developing new ways of delivering and sharing training materials and technical expertise. For example, EO provides a training class on the proper use of the Letter 1312, "Request for Additional Information," which is used when additional information is needed to make a determination on an EO application. This class will continue to focus employees and managers on the letter's proper use in potential political campaign intervention activity cases, and will educate and reinforce understanding of both appropriate and inappropriate questions regarding donors.

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[19] This discussion relates to bipartisan Finding #4 and the related bipartisan Recommendation. See Appendix A, Finding B4, Recommendation B4.1.
[20] IRM 1.54.1, "TE/GE Roles and Responsibilities."
[21] This discussion relates to bipartisan Finding #6 and the related bipartisan Recommendation. See Appendix A, Finding B6, Recommendations B6.1.

In response to three recommendations contained in the 2013 TIGTA Report, during the summer of 2014 the EO function held mandatory training for all EO function employees on political campaign intervention activities. This training comprised written materials, virtual e-Learning sessions, and face-to-face, small-group, technical workshops. In 2014, the EO function began holding quarterly continuing professional education (CPE) sessions and Interim Guidance Awareness training. The content of the CPE sessions varies, but typically focuses on EO tax law topics. Refresher training on Interim Guidance is a refresher course/update, delivered virtually, on the content of prior pieces of interim guidance such as roll-out of the Emerging Issues Committee and coverage of IRS Counsel-approved case development questions.

Looking ahead and responsive to the Finance Committee's interest, as part of its continuing effort to further reduce its inventory of over-age cases, the EO function has scheduled October 2015 training for determinations specialists on quality standards, including timely case processing standards.

While the use of virtual e-Learning tools enables employees to receive training from subject-matter experts at reduced costs, the IRS is aware of the need to ensure that technical content is delivered successfully and that attendance is monitored carefully. To that end, the IRS is using a refined and improved methodology to verify virtual training attendance. The EO Program Management Office (PMO) now coordinates training events for the EO function and tracks and reports on training attendance. Employees are required to retake all training sessions they fail to complete. If an employee, including a manager, fails to attend a required training session, PMO notifies both the employee and the employee's manager to ensure attendance in the near future. Further, the failure of an employee, or manager, to attend mandatory training sessions will be documented in their performance evaluations.

In addition to the new technical assistance procedures, the EO function is currently implementing a knowledge management (KM) network which, when completed, will provide EO function employees with easy access to information on a wide range of technical issues, including, for example, unrelated business income tax and private foundations. The information will highlight the relevant law, applicable revenue rulings and guidance, and frequently encountered issues. Employees will also have access to KM subject-matter experts for additional guidance and assistance. This process will increase information sharing across the EO function while improving consistency in how employees approach technical issues. The EO function has begun to deliver periodic training events focused on its new knowledge management processes, including their purpose, benefits, and how to access KM services for all employees through the new KM system.

## Ensuring Neutral Review Processes[22]

The EO function has taken definitive steps to ensure a neutral review process for organizations applying for tax-exempt status. First, the EO function has focused on preventing improper requests for donor identities at the application stage. Following the release of the 2013 TIGTA Report, the IRS provided guidance to EO function employees on processing applications for tax-exempt status when an organization provides information on Forms 1023 or 1024 that is insufficient for the IRS to reach a conclusion regarding exempt status.[23] As of 2014, the IRS has implemented new procedures to ensure that requests for additional information in cases involving potential political campaign intervention activities are appropriate in scope and scale.[24] A template letter, Letter 1312, "Request for Additional Information," was developed through careful coordination among the Office of Chief Counsel, the Office of Taxpayer Correspondence, and the Taxpayer Advocate Service's (TAS) Office, and it does not contain any questions relating to names of donors. EO Determination specialists are now instructed to use Letter 1312 in developing all such cases, and specialists must submit all development letters to their group manager for review and approval prior to issuance to an organization. The categories of questions that are contained in the template Letter 1312 have been made available to the public on the IRS website since January 2014,[25] and are updated as necessary.

Additionally, the IRS will continue to review and improve its EO examination case selection internal control system, an issue which was the subject of a detailed discussion in the Finance Committee's bipartisan report.[26] Following the recommendations contained in the July 2015 GAO Audit report,[27] the EO function issued revised procedures for the composition and operation of the Political Activity Referral Committee.[28] Pursuant to the revised procedures, the Committee will consist of three EO managers, selected at random. The managers will receive appropriate training and serve on the committee for two years. These procedures will ensure the committee will review and recommend referrals for audit in an impartial and unbiased manner. The Committee must identify and document in the case file that the referral and associated publicly available records establish that an organization, and any relevant persons associated with that organization, may not be in compliance with Federal tax laws. The EO function has moved quickly to implement the new procedures. The first three Committee members under this new procedure were selected in the beginning of August 2015. EO is committed to conducting regular reviews to ensure that Committee members operate in accordance with all aspects of the Interim Guidance.

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[22] This discussion relates to bipartisan Finding #2, and the related bipartisan Recommendation, #1, as well as bipartisan Finding #7, and the related bipartisan Recommendation #1. See Appendix A, Findings B2 & B7, Recommendations B2.1, & B7.1.

[23] Interim Guidance Memorandum, TE/GE-07-1014-0027 (October 24, 2014).

[24] Interim Guidance Memoranda, TE/GE-07-1214-0030 (December 10, 2014) and TE/GE-07-1214-0032 (December 23, 2014).

[25] www.irs.gov/Charities-%26-Non-Profits/Charitable-Organizations/Exempt-Organization-Sample-Questions.

[26] See the Finance Committee Report at pp. 128-29.

[27] IRS Examination Selection Internal Controls for Exempt Organization Selection Should Be Strengthened" (GAO-15-514) (July 2015).

[28] Interim Guidance Memorandum TE/GE-04-0715-0018 (July 16, 2015). See Appendix C.

The Department of the Treasury and the IRS have also begun the process of developing guidance under section 501(c)(4) on how to measure social welfare and non-social welfare activities.[29] The goal of this guidance project is to move the EO determination process away from a subjective "facts and circumstances" analysis and toward more objective standards. This effort has been greatly informed by the more than 160,000 public comments received in response to the 2013 proposed regulations. Treasury and the IRS asked for, and received, comments on several issues, including three major issues: the proposed definition of political campaign activity; to which organizations that definition should apply; and the amount of political activity an organization can engage in consistent with a particular tax-exempt status. Ultimately, Treasury and the IRS strive to develop guidance that is clear, fair to everyone, and easy to administer.

Finally, the IRS has always maintained a general practice of not involving political appointees in the handling of specific taxpayer matters.[30] Instead, for EO taxpayers, such matters should be resolved by the TE/GE Commissioner or the Deputy Commissioner, Services and Enforcement. The EO function provides SCRs to the TE/GE Commissioner, and those SCRs are reviewed by the TE/GE Commissioner and forwarded to the Deputy Commissioner, Services and Enforcement, as needed.

## Improving Procedures under the Freedom of Information Act[31]

It is important to distinguish FOIA requests, which are worked by the IRS Disclosure Office, from other types of requests for IRS records. Similar to requests for administrative case files, which are worked by the IRS business units, requests seeking copies of tax exempt applications under section 6104 are worked by EO's Rulings & Agreements Processing Section, Correspondence Unit, and not processed as FOIA requests by the Disclosure Office.

Regarding FOIA requests, the IRS Disclosure Office uses an established network of contacts in each of the various business units to serve as subject-matter experts and coordinate searches within their organizations. The Disclosure Office relies on the business unit contacts to identify the existence and location of responsive documents, and to coordinate with the custodian offices.[32] The Disclosure Office and the business unit contacts maintain open lines of communication, and follow-up up with FOIA requestors to better define the scope of their requests whenever there are questions.[33] This approach is intended to maximize public access to agency records. Similarly, IRS guidance describes opportunities to extend the search to records created after the date of the request if the search effort is drawn out or was not timely

[29] This discussion relates to Majority Recommendation #5, p. 267, as well as Minority Recommendation #2, p. 314. See Appendix A, Recommendations Maj5 & Min11.
[30] Per IRM 1.54.1.9.1 (updated 12-20-2013), the IRS has a general practice of not involving political appointees (viz., the Commissioner of Internal Revenue and the IRS Chief Counsel) in the handling of specific taxpayer matters.
[31] This discussion relates to bipartisan Findings #8 & #9, and the related bipartisan Recommendations. See Appendix A, Findings B8 & B9, Recommendations B8.1, B9.1, & B9.2.
[32] Generally, the IRS keeps records in files, e.g., exam files, collection files, and regulation files. When a FOIA request is vague or describes a broad program or process, it can be much more difficult to locate custodians and responsive records. See IRM 11.3.13.5.5(6) and IRM 11.3.13.6.2(10); (08-14-2013).
[33] IRM 11.3.13.6.2 & 11.3.13.6.3(13); (08-14--2013).

initiated in an effort to provide the requester with access to as many responsive records as possible. In all cases, the IRS's search efforts must be documented, whether or not responsive records exist.

To ensure that Disclosure Office employees at all experience levels have the tools they need to conduct robust searches for FOIA requests, which are increasingly complex in scope and volume, the Disclosure Office is preparing guidance in the form of written standard search procedures. This guidance will focus on many of the more frequently requested categories of information and include contact lists. Employees processing FOIA requests will be trained in those procedures by the end of 2015.

The Disclosure Office's existing FOIA procedures require secondary review of all FOIA documents when records are denied in part or in full for the proper application of the FOIA exemptions before release.[34] The Office of Disclosure also has an embedded quality review process pursuant to which a sample of all FOIA releases are reviewed against quality standards, including a measure of technical accuracy of the records released. The Disclosure Office will issue a directive by September 30, 2015 emphasizing the importance of continuing to focus on the adequacy of each search effort, emphasizing the IRM requirements and stressing the need to document where deficiencies exist.[35] Additionally, TIGTA conducts periodic reviews of the IRS's compliance with FOIA. In some instances, TIGTA has noted incidences of improper disclosures.[36] The IRS responded to those reports by conducting additional training for FOIA caseworkers.

In May 2015, the EO function released new procedures for handling FOIA requests. These procedures were shared with the EO Functional Directors and will be incorporated into Interim Guidance. Under the new procedures, all FOIA requests will be coordinated through the EO Program Management Office. That office will document and track all requests, verify whether the request relates to efforts by other IRS business functions, coordinate with the Disclosure Office to determine the appropriate scope of the request, and reach out to the appropriate EO points of contact contained within each EO function. These new procedures will assist in ensuring that searches are appropriately conducted across all components of the EO function, as recommended by the Finance Committee.

## Reviewing the Use of the Office Communicator System[37]

The Finance Committee's Findings and Recommendations raise important questions about records retention, as well as questions regarding IRS employee use of the Office Communicator System (OCS). Similar to an internal instant messaging system, OCS enables IRS employees to hold virtual meetings, as well as virtual training events involving large numbers of employees and offices. These functionalities reduce expenses for travel and meeting space. In December

[34] IRM 11.3.13.8(3) and (9); (08-14-2013).
[35] IRM 11.3.13.6.3 (8-14-2013).
[36] TIGTA report 2014-30-064 (9-17-2014); See https://www.treasury.gov/tigta/auditreports/2014reports/201430064fr.pdf.
[37] This discussion relates to bipartisan Finding #10 and the related bipartisan Recommendation. See Appendix A, Finding B10, Recommendations B10.1.

2014, the IRS conducted a review of employee use of OCS, and found that, in addition to its business uses, it is most often used as an informal means of communication. To address the need to maintain and safeguard Federal records that may be created in OCS, the IRS, in coordination with National Archives and Records Administration, is developing policies and practices that are consistent with Federal recordkeeping requirements. Currently, the IRM advises employees who create Federal records using informal means of documentation or communication, including OCS, to convert those records to a more structured format to facilitate records management and enable appropriate retention.[38] The IRS plans to improve this guidance by adding more specific instructions and clarifying examples.

## Responding to Government Accountability Office Recommendations[39]

The GAO's July 2015 report made ten recommendations addressing a range of issues, including: the substance and currency of the IRM; EO case selection controls; EO examination criteria, approval and oversight, additional controls, and database maintenance; referral training and referral controls; and closed file tracking and maintenance.

The IRS generally agrees with the GAO's recommendations. The EO function has already begun developing action plans to address each of them, and it is making progress towards doing so. For example, the GAO recommended that the IRS ensure that referral committee members rotate every 12 months by soliciting volunteers, and suggested the EO function should revise the IRM to require an alternative rotation schedule if 12 months is not appropriate. As explained above, the EO function released interim guidance[40] in July 2015, announcing new procedures for the Political Action Referral Committee that are consistent with the GAO recommendations. In response to other GAO recommendations, the EO function has already set FY 2016 target dates for completion of IRM updates and operational reviews.

The EO function will continue addressing all ten GAO recommendations, as quickly as it can, and the IRS will report to Congress on its progress in Fall 2015.

## Recommendations outside IRS Jurisdiction or that Require Legislative Changes

The Finance Committee Report contains several recommendations that are outside the jurisdiction of the IRS. One recommendation suggested the creation of a position within the Taxpayer Advocate Service (TAS) dedicated solely to assisting organizations applying for non-profit tax-exempt status.[41] TAS is preparing a separate response to the Finance Committee. However, it is our understanding that TAS has already begun to address this recommendation. Thus far, TAS has recently created several positions relating to exempt entities: a Revenue

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[38] The Federal Records Act requires that the agency maintain agency records, *i.e.*, records created, compiled or received in the course of agency business. The IRS policy on emails is that all emails that relate to agency business should be printed and kept with the file, and that work-related emails are subject to FOIA and discovery. IRM 1.10.3.2.4; IRM 1.10.3.3.5 (03-06-2015).

[39] This discussion relates to bipartisan Finding #7, and the related bipartisan Recommendation #2. See Appendix A, Finding B7, Recommendation B7.2.

[40] TE/GE-04-0715-0018 (July 16, 2015).

[41] This discussion relates to bipartisan Finding #1 and the related bipartisan Recommendation #3. See Appendix A, Finding B1, Recommendation B1.3.

Agent Technical Advisor with specific exempt organization expertise to assist all of TAS's Local Taxpayer Advocate offices with complex EO cases; and a Systemic Advocacy Analyst with EO background and expertise who reviews and identifies systemic problems relating to EOs. TAS also has two attorney-advisors who work EO legal issues and EO cases referred to TAS, one of whom reports directly to the National Taxpayer Advocate.

Additionally, TAS plans to hire a mid-level Advocacy Specialist in the Washington, DC, Local Taxpayer Advocate office, who will focus on the most complex and disputed EO cases. The Advocacy Specialist will spend half the time working on cases in a particular area of expertise and the other half on systemic issues such as: handling of cases, training, the Annual Report to Congress, and serving on IRS teams, with respect to EO. TAS is working on drafting a full description of the Advocacy Specialist position and will announce it in the near future.

Another bipartisan recommendation focused on revisions to the Hatch Act.[42] The proposal would require legislative action and accordingly, the IRS has not taken action responsive to this recommendation. Similarly, the Majority and the Minority each prepared lists of several recommendations calling for legislative changes. These recommendations included, for example, amending the Federal Service Labor-Management Relations statute to designate the IRS as exempt from labor organization and collective bargaining requirements,[43] amending section 7428 to provide for declaratory judgment actions by applicants for tax-exempt status under section 501(c)(4), (5), and (6),[44] and amending several other Internal Revenue Code provisions relating to exempt organizations.[45]

In addition, the Committee recommended that TIGTA conduct a review of the revised EO Examination procedures, no later than July 1, 2017.[46] The IRS is ready and willing to cooperate with any future TIGTA review.

Finally, both the Majority and Minority sections of the Report address the possibility of removing the IRS from under the authority of the Department of the Treasury and establishing it as an independent, stand-alone agency.[47] This recommendation raises numerous legal and policy issues, and is outside the jurisdiction of the IRS. Accordingly, the IRS does not intend to take any action responsive to this recommendation.

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[42] This discussion relates to bipartisan Finding #1 and the related bipartisan Recommendation #2. See Appendix A, Finding B1, Recommendation B1.2.
[43] This discussion relates to Majority Recommendation #2, p. 267. See Appendix A, Recommendation Maj2.
[44] This discussion relates to Majority Recommendation #3, p. 267. See Appendix A, Recommendation Maj3.
[45] This discussion relates to Majority Recommendation, p. 258. See Appendix A, Recommendation Maj6.
[46] This discussion relates to bipartisan Finding #7 and the related bipartisan Recommendation #3. See Appendix A, Finding B7, Recommendation B7.3.
[47] This discussion relates to Majority Recommendation #1, p. 267. See Appendix A, Recommendation MAj1.

## Conclusion

The Finance Committee's extensive investigation of the IRS's processing of applications for tax-exempt status submitted by "political advocacy" organizations from 2010-2013 spanned the full breadth of the IRS's EO operations. The Finance Committee's thorough, detailed, and balanced bipartisan report chronicles many problems with those operations, including but not limited to: the IRS's interactions with applicants; its handling of their applications; management oversight of the EO process; IRS organizational structures; manager and employee training; and taxpayer confidentiality and access to records. The Finance Committee's report also shows the path forward, however, by laying down a series of specific findings and recommendations.

Throughout the Finance Committee's investigation, and continuing today, the IRS has been working hard to move along that path towards its goal of providing top quality service to America's exempt organizations. To that end, the IRS will continue to address the Report's bipartisan findings and recommendations, as well as all the recommendations prepared by the Majority and Minority staffs. As discussed in this report, the IRS has already taken significant and important actions to address the problems identified by the Finance Committee, and those actions are resulting in substantive improvements.

## Appendix A – Finance Committee Findings and Recommendations

### 1. Bipartisan (B) Findings and Recommendations

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
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| B1 | The IRS's handling of applications from advocacy organizations may affect public confidence in the IRS. To avoid any concerns that may exist that IRS decisions about particular taxpayers are influenced by politics, the following recommendations are made. | B1.1 | Publish in the instructions to all relevant application forms objective criteria that may trigger additional review of applications for tax-exempt status and the procedures IRS specialists use to process applications involving political campaign activity. Prohibit the IRS from requesting individual donor identities at the application stage, although generalized donor questions should continue to be allowed, as well as requests for representations that, e.g., there will be no private inurement. | 8 | Promoting Transparency and Accessibility in the EO Determination Process (2) |
| | | B1.2 | Revise the Hatch Act to designate all IRS, Treasury and Chief Counsel employees who handle exempt organization matters as "further restricted." "Further restricted" employees are held to stricter rules than most government employees and are precluded from active participation in political management or partisan | 8 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | | | campaigns, even while off-duty. By designating those employees as "further restricted," the public can be assured that any impermissible political activity by an IRS employee that is detected will result in serious penalties, including removal from federal employment. | | |
| | | B1.3 | Create a position within the Taxpayer Advocate Service dedicated solely to assisting organizations applying for non-profit tax-exempt status. | 8 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| B2 | The IRS systematically screened incoming applications for tax-exempt status from more than 500 organizations and implemented procedures that resulted in lengthy delays. Until early 2012, certain top-level management was unaware that these applications were being processed in this | B2.1 | The Exempt Organizations division 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. A list of over-aged cases should be sent to the Commissioner of the Internal Revenue Service quarterly. | 9 | Streamlining the EO Determination Process to Ensure Timely Processing and Reduce Delay (3)<br><br>Fostering a Culture of Accountability (5)<br><br>Ensuring Neutral Review Processes (8) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
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| | manner. | | | | |
| | | B2.2 | The Exempt Organizations division 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. | 9 | Streamlining the EO Determination Process to Ensure Timely Processing and Reduce Delay (3)<br><br>Fostering a Culture of Accountability (5) |
| | | B2.3 | The Exempt Organizations division should track requests for guidance or assistance from the Office of Chief Counsel so that management can assess the timeliness and quality of the guidance and assistance it provides to both the Determinations Unit employees and the public. Any requests for guidance or assistance from the Office of Chief Counsel that have not been responded to on a timely basis should be promptly reported to the Commissioner of the Internal Revenue Service. | 9 | Streamlining the EO Determination Process to Ensure Timely Processing and Reduce Delay (3)<br><br>Fostering a Culture of Accountability (5) |
| B3 | The IRS took as long as five years to come to a decision on applications for tax-exempt status submitted by Tea Party | B3.1 | The Internal Revenue Manual contains standards for timely processing of cases. Enforce these existing standards and discipline employees who fail to follow them. Managers should also be held accountable if their | 9 | Fostering a Culture of Accountability (5) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | and other applicants potentially involved in political advocacy. The IRS lacked an adequate sense of customer service and displayed very little concern for resolving these cases. | | subordinates fail to follow these standards. | | |
| | | B3.2 | For all types of tax-exempt applicants, IRS guidelines should direct employees to come to a decision on whether or not it will approve an application for tax-exempt status within 270 days of when an application is filed. | 9 | Streamlining the EO Determination Process to Ensure Timely Processing and Reduce Delay (3) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| B4 | Important issues were not elevated within the IRS. Some Sensitive Case Reports containing information about Tea Party applications were sent to top IRS managers in 2010, but the managers did not read them. | B4.1 | Revise the Sensitive Case Report process or develop a more effective way to elevate important issues within the organization other than the Sensitive Case Reports system. Require the senior recipient of each Sensitive Case Report within the Division (a member of the Senior Executive Service) to memorialize specific actions taken in relation to each issue raised in the report, and require such report to be forwarded to the IRS Commissioner for review. | 9-10 | Strengthening Risk Management through Improved Communication (6) |
| B5 | A contributing factor to the IRS's management problems was the decentralization of its employees, including some who worked from home as often as 4 days per week, and managers who remotely supervised employees 2,000 miles away. | B5.1 | Evaluate whether current organizational structures and workplace locations are inhibiting performance. Make appropriate adjustments to improve communication between employees and their managers. | 10 | Realigning Organizational Functions for Improved Service (4) |
| B6 | Some managers within the EO Division were | B6.1 | Set minimum training standards for all managers within the EO division to | 10 | Bolstering Employee Training (6) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | not trained in the substantive tax areas that they managed, including one who did not complete any technical training during the 10 years that she served in a managerial EO position. | | ensure that they have adequate technical ability to perform their jobs. | | |
| B7 | The IRS did not perform any audits of groups alleged to have engaged in improper political activity from 2010 through April 2014. During that time, the IRS tried to implement new processes to select cases for examination, but a memo from Judy Kindell, Sharon Light and Tom Miller stated that this approach "arguably [gave] the impression that somehow the political leanings of [the | B7.1 | Review the recently-enacted procedures to determine if: (1) the process enables the IRS to impartially evaluate allegations of impermissible political activity; (2) any of the referrals have resulted in the IRS opening an examination related to political activity, and if so, whether such an examination was warranted; and (3) if necessary, the IRS should make further modifications to ensure that it carries out the enforcement function in a fair and impartial manner. | 10 | Ensuring Neutral Review Processes (8) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | organizations] mentioned were considered in making the ultimate decision." The IRS recently discontinued use of the Dual Track process and now uses generalized procedures when deciding whether to open an examination of an exempt organization's political activities. | | | | |
| | | B7.2 | The IRS should fully implement all recommendations of the Government Accountability Office in their July 2015 report titled "IRS Examination Selection: Internal Controls for Exempt Organization Selection Should be Strengthened," GAO-15-514. | 10 | Response to Government Accountability Office Recommendations (11) |
| | | B7.3 | No later than July 1, 2017, we request that TIGTA conduct a review of the three points noted above in Recommendation #1 related to the revised EO Exam procedures. | 10 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| B8 | On multiple occasions, the IRS improperly | B8.1 | Require all outgoing FOIA responses to be reviewed by a second employee | 11 | Improving FOIA Procedures (9) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | disclosed sensitive taxpayer information when responding to Freedom of Information Act (FIOA) requests. Employees who were responsible for these disclosures received minimal or no discipline. | | to ensure that taxpayer information is not improperly disclosed. | | |
| B9 | In 2010, the IRS received a FOIA request from a freelance journalist seeking information about how the agency was processing requests for tax-exempt status submitted by Tea Party groups. After 7 months, the IRS erroneously informed the journalist that they did not possess any documents that were responsive to her request. | B9.1 | Ensure that IRS procedures specify which organizational units within the agency should be searched when the IRS receives an incoming FOIA request on a particular topic. For example, when the IRS receives a FOIA request for records related to tax-exempt applications, the agency should search the records of all components within the Exempt Organizations division. | 11 | Improving FOIA Procedures (9) |
| | | B9.2 | To be consistent with the intent of | 11 | Improving FOIA |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | | | FOIA, employees handling FOIA requests should construe the requests broadly and contact the requestor to clarify the scope of the request whenever necessary. However, the IRS should also take appropriate measures to safeguard taxpayer information and avoid improper disclosure. | | Procedures (9) |
| B10 | The IRS has made Office Communicator Server (OCS) instant messaging software available to its employees. Under the collective bargaining agreement with the National Treasury Employees' Union, the IRS agreed that it would not automatically save messages sent to and from employees. As a result, messages can only be recovered if an employee elected to save them. TIGTA opined that this policy | B10.1 | The IRS should review how employees use OCS. If the program is not used for IRS business, the agency should evaluate whether it is appropriate and necessary. If OCS is used for official IRS purposes, the IRS should take measures to ensure such use complies with federal recordkeeping laws. | 11 | Review the Use of the Office Communicator System (10) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | does not necessarily violate federal recordkeeping laws, but noted that "[w]hether OCS is being used according to NARA's guidance depends on how OCS end-users are utilizing the system." | | | | |

## 2. Majority (Maj) Recommendations

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | | Maj1 | The IRS must be removed from the authority of the Treasury Department and established as an independent stand-alone agency. | 267 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Maj2 | The Federal Service Labor-Management Relations Statute must be amended to designate the IRS as an agency that is exempt from labor organization and collective bargaining requirements. | 267 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Maj3 | Congress should amend section 7428 of the Internal Revenue Code to enable applicants for tax-exempt status under 501(c)(4), (5), and (6) to seek a declaratory judgment if the IRS has not rendered a decision on whether or not it will approve an application within 270 days. Doing so would afford these organizations the same remedy currently available only to 501(c)(3) organizations, thereby advancing parity among nonprofits. | 267 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | | Maj4 | A key finding of this report is that many small organizations with limited resources were overwhelmed by unduly burdensome IRS demands. We recommend that the IRS establish a streamlined application process for small organizations applying for tax exemption under 501(c)(3) and 501(c)(4) that enables them to avoid unnecessary administrative burdens, provided that appropriate conditions are satisfied. | 267 | Streamlining the EO Determination Process to Ensure Timely Processing and Reduce Delay (3) |
| | | Maj5 | Any further attempt by the IRS to promulgate regulations revising the standard for determining whether section 501(c)(4) organizations have engaged in political campaign intervention must not chill the free exercise of political speech by those organizations, nor disproportionately affect organizations on either side of the political spectrum. | 267 | Ensuring Neutral Review Process (8) |
| | | Maj6 | Legislative proposals that would require near-universal disclosure of donors, such as those advanced by the Minority Staff, should be rejected. | 258 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |

## 3. Minority (Min) Recommendations

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | | Min1 | Require (c)(4)s, (5)s, and (6)s to file notice of formation within 24 hours (same as 527s). | 313 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Min2 | Create a bright-line test on political activity (lobbying and campaigning) – for example, a limitation of 10% of expenditures during the calendar year. | 313 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Min3 | Penalty: Apply Section 4955 penalty to (c)(4)s – excise tax on excess political expenditures. | 313 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Min4 | Require the disclosure of donors who contribute over $200 to 501(c)(4)s who engage in political activity (same as 527 organizations), or $1,000, which is the threshold in the Wyden-Murkowski bill. | 313 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Min5 | Require FEC filings to be attached to 990s. | 314 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |

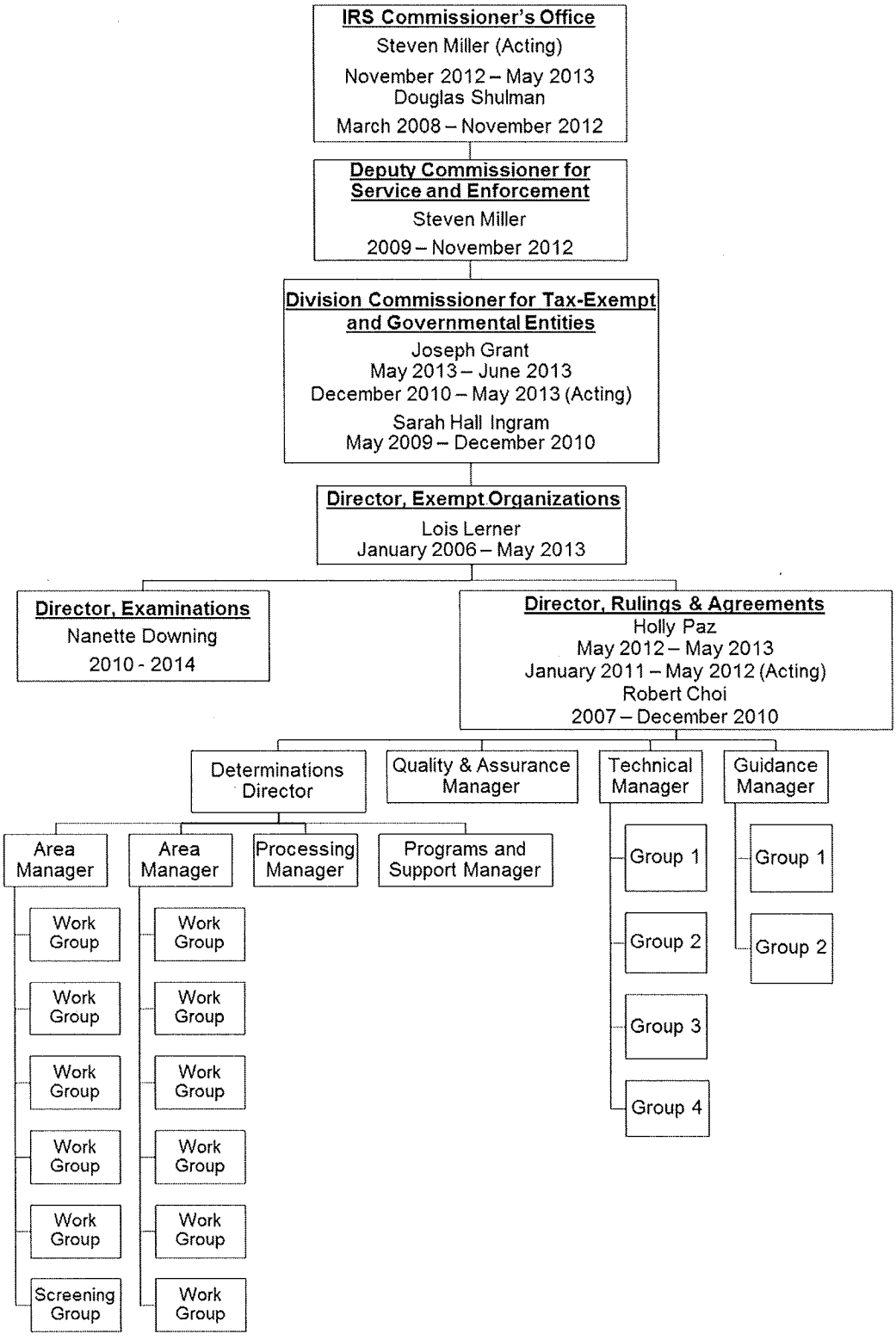
| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | | Min6 | Require electronic filing of 990s (included in the Senate Finance Committee's Tax Administration Discussion Draft). | 314 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Min7 | As an alternative, require disclosure similar to 527 organizations (or by cross reference) for tax exempt organizations that do any "electioneering communications" as defined under FEC rules. | 314 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Min8 | As an alternative, require tax exempt organizations that wish to fund electioneering communications to fund these operations through a segregated 527 account, thus, contributions would be subject to disclosure. | 314 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |
| | | Min9 | As an alternative, require these organizations be reclassified as 527 organizations. | 314 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | | Min10 | The Follow the Money Act introduced by Chairman Wyden and Senator Murkowski requires that all individuals and entities engaged in independent political spending, including 501(c)(4)s, disclose the names of donors that contribute over $1,000 per year. The legislation also requires real-time disclosure of significant independent political expenditures by 501(c)(4)s similar to the way political candidates report spending to the FEC. This legislation would lessen the processing burden on the IRS Exempt Organizations office because its disclosure regime will eliminate the incentive for organizations to apply for tax-exempt 501(c)(4) status as a means to funnel large anonymous donations into federal elections. | 314 | Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11) |

| Finding | Description | Recommendation | Description | Finance Committee Report Page # | IRS Report Subheading (Page #) |
|---|---|---|---|---|---|
| | | Min11 | A final option which would not require changes in law envisions the IRS reversing its decision in 1959 to interpret "exclusively" as meaning "primarily." The regulatory decision that has led to hundreds of millions of dollars of political spending by "social welfare" organizations could be cancelled by another regulatory decision setting the same standards that applied before 1959. | 314 | Ensuring Neutral Review Processes (8) |
| | | Min12 | The Democratic staff recommends that additional work be done to determine what reforms to 501(c)(5) and 501(c)(6) organizations are needed. | 314 | Streamlining the EO Determination Process to Ensure Timely Processing and Reduce Delay (3) |

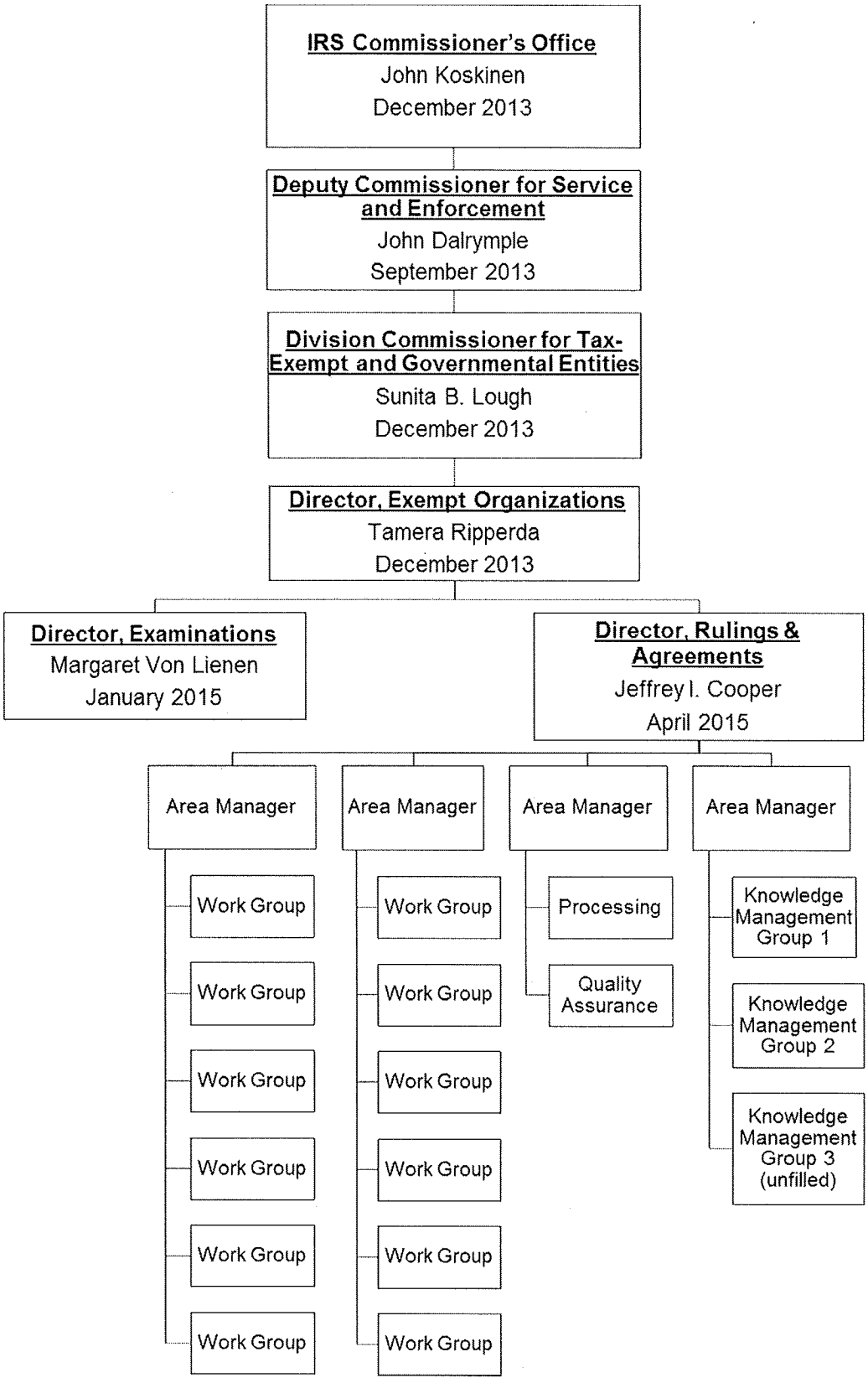
## Appendix B – Comparison of Organization Charts for TE/GE's Exempt Organizations[48]

### 1. EO Rulings & Agreements Organization Chart during the SFC's Investigation




[48] Note: these charts represent the Exempt Organizations - Rulings and Agreements group, which is one segment within the IRS's Tax-Exempt and Government Entities business division, and the focus of the SFC investigation.

## 2. Current EO Rulings and Agreements Organization Chart



# Appendix C - Interim Guidance Memorandum, TE/GE-04-0715-0018 (July 16, 2015)

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

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

July 17, 2015

Control No: **TEGE-04-0715-0018**
Affected IRM: 4.75.5
Expiration Date: July 16, 2017

MEMORANDUM FOR ALL EXEMPT ORGANIZATIONS MANAGERS

FROM: Tamera L. Ripperda
Director, Exempt Organizations

SUBJECT: Political Activities Referral Committee

This memorandum clarifies the composition and operations of the Political Activities Referral Committee (PARC).

Effective immediately, a PARC will consist of three IR-04 managers (OPM General Schedule (GS) grade 14 equivalent) who will be selected at random. All EO Examinations and Rulings & Agreements front-line IR-04 managers are eligible for selection to a PARC. The managers who are selected to serve on a PARC will receive appropriate training, and will serve on that committee as a collateral assignment for a period of two years. The inventory volume of political activities referrals received will determine the number of PARCs established and the time commitment required by the members of a PARC.

A PARC will review and recommend referrals for audit in an impartial and unbiased manner. A PARC must identify and document to the case file that the referral and associated publicly available records establish that an organization and any relevant persons associated with that organization may not be in compliance with Federal tax law. All PARC members will use the Reporting Compliance Case Management System (RCCMS) to document their activities and conclusions for the duration of their assignment to a PARC. In order for a referral considered by the PARC to be forwarded to an EO Examination group for audit consideration, two out of three PARC members must make that forwarding recommendation (majority rule).

Referral Classification Specialists will follow normal referral case building procedures prior to submitting a referral to a PARC. This includes, but is not limited to, IDRS information, Accurint, any internet research and the completion of the Classification Lead Sheet. See attached Exhibit for the Classification Lead Sheet.

This memorandum supersedes IG Memo, *Procedures for Dual Track Approach for Issues Involving Possible Political Campaign Intervention*, issued October 4, 2012.

This memorandum will expire on the earlier of two years from the date of issuance or the date incorporated in the affected IRMs. If there are any questions regarding this memorandum, those questions should be directed to the EO Examinations Referrals Manager.

ATTACHMENT

DISTRIBUTION:
www.irs.gov

| Classifications Lead Sheet | | | | | | |
|---|---|---|---|---|---|---|
| EIN | | MFT | | Year(s) | | |
| TE/CLERICAL | | | | | | |
| Classifier | | | | | | |
| EO Name | | | | | | |
| Address | | | | | | |

| COMPLETED BY REVENUE AGENT (SECTIONS I - IV) | | |
|---|---|---|
| SECTION I - RECOMMENDATION | | |
| Accept As Filed | Field Exam | Other actions deemed necessary |
| | | |
| RECOMMENDATION: Referred Issue/ Facts/ Law/ Conclusion | | |
| | | |

| ORGANIZATION WEBSITE |
|---|
| Does the Organization Have a Valid Website? If so, Enter web address |
| |
| Describe contents (activities, programs/services) and list any significant items of interest |
| |

| EXAM POTENTIAL/LARGE UNUSUAL QUESTIONABLE ITEMS |
|---|
| |