

**THE INTERNAL REVENUE SERVICE'S RESPONSE  
TO COMMITTEE RECOMMENDATIONS  
CONTAINED IN ITS AUGUST 5, 2015 REPORT**

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**HEARING**

BEFORE THE

**COMMITTEE ON FINANCE  
UNITED STATES SENATE**

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

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OCTOBER 27, 2015

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**THE INTERNAL REVENUE SERVICE'S  
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AUGUST 5, 2015 REPORT**

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**TUESDAY, OCTOBER 27, 2015**

U.S. SENATE,  
COMMITTEE ON FINANCE,  
*Washington, DC.*

The hearing was convened, pursuant to notice, at 9:04 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee) presiding.

Present: Senators Grassley, Roberts, Enzi, Thune, Isakson, Portman, Coats, Heller, Scott, Wyden, Nelson, Carper, Cardin, Brown, Bennet, and Casey.

Also present: Republican Staff: Kimberly Brandt, Chief Healthcare Investigative Counsel; Chris Armstrong, Deputy Chief Oversight Counsel; Mark Prater, Deputy Staff Director and Chief Tax Counsel; and Justin Coon, Detailee. Democratic Staff: Joshua Sheinkman, Staff Director; Michael Evans, General Counsel; Daniel Goshorn, Investigative Counsel; and Doug Calidas, Legislative Fellow.

**OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S.  
SENATOR FROM UTAH, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The committee will come to order, and I want to welcome everyone to this morning's hearing and thank those who are here today.

In May 2013, the Treasury Inspector General for Tax Administration revealed that, in the run-up to the 2010 and 2012 elections, the Internal Revenue Service had targeted certain organizations applying for tax-exempt status for extra and undue scrutiny based on the groups' names and political views.

Needless to say, we took this matter very seriously. Indeed, at the time, both Republicans and Democrats condemned the agency's actions. And as the Senate committee with exclusive legislative and oversight jurisdiction over the IRS, the Finance Committee launched a bipartisan investigation into the matter. In fact, our investigation was the most thorough and the only bipartisan investigation conducted with regard to these events.

On August 5th of this year, after more than 2 years of investigation, we released a 375-page bipartisan investigative committee report that included approximately 4,700 pages of exhibits. This re-

port is, I believe, the definitive record of what occurred at the IRS and why.

As we all know, last week, the Department of Justice stated publicly that they would not be pressing criminal charges with regard to these events at the IRS. This has led some to argue that the Justice Department is corrupt or biased in some way. Others have said that this decision proves that nothing scandalous occurred at the IRS.

I believe the committee's report speaks for itself on this matter. And, in my opinion, rather than fueling the echo chamber, we would do better to focus on what we know actually happened and what changes need to take place to make sure it does not happen again.

That is why we are here today.

The committee's report included ten major findings that formed the basis of various recommendations for changes that we believe the agency should make to ensure the IRS's actions remain above-board. The purpose of today's hearing is to hear directly from the IRS about their response to our report and their progress in adopting our recommendations. Toward that end, I want to thank Commissioner Koskinen for being here today and for the agency's thoughtful response to our recommendations.

In that response, the IRS indicated that they have implemented all of the bipartisan recommendations from the report that are within the agency's control, as well as the separate majority and minority recommendations.

Our overall goal here should be to restore the credibility of the IRS and ensure that this very powerful agency treats all American taxpayers fairly.

While I want to commend the IRS for the efforts they have made thus far, in my understanding that, up to now, most of the changes they have made have been procedural in nature, and very little has been done to begin work on the needed structural changes at the agency. Today, I hope to hear more details as to why these types of changes are being delayed.

At the same time, I believe the Finance Committee should be considering statutory changes that will improve upon the status quo. For example, there was bipartisan agreement in the report on the need to update the Hatch Act to ensure that, with regard to political activities, IRS employees receive the same considerations as employees of other highly sensitive agencies, like the Federal Election Commission and the Federal Bureau of Investigation.

In addition, as the Majority Views in the report noted, and as I have stated publicly on multiple occasions, I have serious concerns about the influence of labor union activity at the IRS. While I am not anti-union and while I do not oppose collective bargaining in general, we know that two-thirds of IRS workers are represented by a union organization that is very politically active and that a fair number of IRS employees work full-time for the benefit of that union. I do not think it is much of a stretch to argue that such a strong union presence could have contributed to a politicized environment at the IRS.

While current law allows Federal Government employees to be represented by unions, Congress has made a number of excep-

tions to this policy, generally with agencies that have important law enforcement obligations or perform other highly sensitive work. And, while I expect there to be some resistance to this idea, I think it is only reasonable that we take the time to consider whether the IRS should be placed in a similar category.

I hope that today we can have a good discussion and get Commissioner Koskinen's views on these and other legislative proposals. Ultimately, the theme that I want to stress most today is accountability.

Our report clearly shows that political targeting at the IRS resulted from a number of bad decisions made by a number of different officials. However, as of yet, very few of these individuals have been held accountable, while others have since received bonuses and even promotions. While I am concerned about this apparent lack of individual accountability, I am more concerned that the IRS lacks the necessary structural and procedural mechanisms to ensure that, as an agency, it remains accountable.

The recommendations we included in our report were designed to provide this type of accountability, and I look forward to discussing our ideas in more detail today.

Before I conclude, I just want to briefly comment on the ongoing effort at the IRS to enact new regulations regarding the political activities of 501(c)(4) organizations. Obviously, this is an issue that deeply concerns a number of people throughout the country, including members of this committee.

As we know, regulations proposed in 2013 were criticized by people and organizations across the political spectrum and were subsequently withdrawn. That poorly drafted proposal would have created nonsensical rules and constitutionally dubious speech restrictions. Oddly enough, it would have created stricter standards for 501(c)(4) organizations than exist for public charities, which would be a perverse reversal of roles for these types of organizations.

While this issue is not directly related to the committee's report on the IRS's political targeting, I think it is fair to say that the agency still carries with it a cloud of perceived political bias. Therefore, I would caution Commissioner Koskinen and others in the administration that have made this regulation a priority to focus instead on actions to restore the IRS's credibility and to abandon any effort to inject more rules and restrictions into the political process.

I expect that members of the committee will want to discuss this matter today as well because, once again, it is an issue that is on the minds of many people.

With that, I will turn to our distinguished ranking member, Senator Wyden, for his opening remarks.

[The prepared statement of Chairman Hatch appears in the appendix.]

**OPENING STATEMENT OF HON. RON WYDEN,  
A U.S. SENATOR FROM OREGON**

Senator WYDEN. Thank you very much, Mr. Chairman.

In early August, the Finance Committee released the final report on the bipartisan inquiry we undertook to examine the IRS's processing of applications for tax-exempt status. Our investigation looked back at the period between 2010 and 2013. The committee

reviewed 1.5 million pages of e-mails and documents and conducted interviews with more than 30 IRS officials.

The Finance Committee inquiry, colleagues, was the only bipartisan inquiry on either side of Capitol Hill. What we found on a bipartisan basis was alarming bureaucratic dysfunction. Many applicants for tax-exempt status were treated badly and deserved much better service from their government. For example, between 2010 and late 2011, a total of 290 applications for tax-exempt status had been set aside for review. Only two applications had been resolved successfully. Not 200—two. That was unacceptable mismanagement. The investigation, however, did not find any evidence of criminal wrongdoing.

Chairman Hatch and I both took time to speak about our views on the Senate floor when the report was issued. The focus of today's hearing, however, is what the IRS is doing to guarantee, once and for all, that this type of deeply troubling mismanagement never happens again.

The Finance Committee's report included 36 recommendations—18 were bipartisan, 12 were Democratic, and 6 were Republican. Among them:

- Set minimum training standards for managers in the exempt organization office to ensure that these employees can adequately perform their duties.
- Institute a standard policy that employees must reach a decision on all tax-exempt applications within 270 days of when they are filed.
- Create a position with the Taxpayer Advocate's office dedicated solely to helping organizations applying for tax-exempt status, and several others.

I would like to thank the Commissioner for responding to those recommendations in a letter that he sent last month to the chairman and me. My takeaway from the letter is that it is the Commissioner's view that there has been genuine progress made to clean up the mess, and I look forward to hearing his assessment in further detail this morning.

While the Commissioner is here, I also want to address the problem that occurred in Martinsburg, WV. Several IRS employees in Martinsburg deleted backup tapes that likely contained e-mails that were within the scope of the committee's inquiry while it was ongoing.

That mistake was completely unacceptable, and it was inexcusable. There are also several reports that there was some lying afterward. Commissioner, that just cannot happen again. I want to hear what the IRS is doing this morning to fix it.

Finally, on Friday the committee received a detailed letter from the Department of Justice concerning their investigation into this matter, and I ask unanimous consent that that be entered into the record.

The CHAIRMAN. Without objection.

[The letter appears in the appendix on p. 82.]

Senator WYDEN. One last point. The chairman mentioned this question of the 501(c)(4) groups, and I want to be clear on this point.



The vast majority of Americans want disclosure in political spending. They want all sides to be more open and more straightforward on these issues. The American people overwhelmingly disapprove of the *Citizens United* decision that knocked down some of the key limits on political campaign spending. If there is no oversight of who receives 501(c)(4) status, meaning anybody could get it and hide their donor list, then political spending will be hidden even deeper in the shadows.

So my request to you on this point, Mr. Commissioner, is that you all work with this committee, Democrats and Republicans, in a bipartisan fashion, to get this right.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Well, thank you, Senator Wyden.

[The prepared statement of Senator Wyden appears in the appendix.]

The CHAIRMAN. Today's witness is the Honorable John Koskinen, the 48th Commissioner of the Internal Revenue Service. Commissioner Koskinen was confirmed to this position in December 2013. Prior to his appointment to lead the IRS, he served for 4 years at Freddie Mac, where he served for a period as the Acting Chief Executive Officer. Before that time, Commissioner Koskinen held various high-profile positions in public service, including President of the U.S. Soccer Foundation, Deputy Mayor of the District of Columbia, Deputy Director for Management at the Office of Management and Budget, and President Clinton's Chair of the President's Council on Year 2000 Conversion.

The Commissioner also spent more than 2 decades in the private sector, including time as CEO and chairman of The Palmieri Company. Commissioner Koskinen has a law degree from Yale University School of Law and a bachelor's degree from Duke University.

We welcome you back to the Senate Finance Committee, Commissioner Koskinen, and we want to thank you once again for being here today. So you can proceed with your opening remarks, and I would ask you, if you can, to limit your opening statement to 5 minutes.

**STATEMENT OF HON. JOHN A. KOSKINEN, COMMISSIONER,  
INTERNAL REVENUE SERVICE, WASHINGTON, DC**

Commissioner KOSKINEN. Chairman Hatch, Ranking Member Wyden, and members of the committee, thank you for the opportunity to discuss the work the IRS has been doing to correct the mistakes associated with the determination process for tax-exempt status 2 years ago.

Let me reiterate my belief that the IRS must continue to do everything possible to make sure all individuals and organizations can be confident that they will be treated fairly in their dealings with this agency. They need to know they will receive fair, unbiased treatment, regardless of their political affiliation, their position on political issues, or whom they supported in the last election. And when someone hears from us regarding their tax return, they need to understand it is only because of something that is or should be on their return and not other factors. And if someone else has the same issue regarding their return, they will hear from us as well, within the limits of our budget resources.

It is important because, even with our declining resources, the IRS will still audit over 1 million taxpayers this year, and they need to be confident they are going to be treated fairly and in an objective manner.

The situation described by the Inspector General in his May 2013 report should never have happened, and we are doing everything possible to ensure that the mistakes referenced in the IG's report and reflected in the committee's bipartisan report do not happen again. As part of our work to move forward, we have implemented all of the recommendations from the IG's report. The IG noted our efforts in a follow-up report issued in March of this year.

As to the Finance Committee's own investigation, I am pleased to report, as noted, that the IRS has accepted all of the recommendations in the committee's report that are within our control, and that includes recommendations in the majority report and the minority report. And we have already made significant progress in implementing those recommendations. Let me briefly summarize the actions we have taken thus far.

We have taken steps to ensure the determination process for tax-exempt status is transparent and the public can easily obtain information on the procedures necessary to obtain a determination.

We have reduced the processing times for applications for tax-exempt status, and we are committed to resolving all cases within 270 days, as the committee has recommended. And in fact, the cycle time right now as a result of the work we have undertaken over the last 2 years is down to 112 days.

We continue to develop new training and workshops for employees on a number of critical issues connected with the application process for tax-exempt status.

We have established procedures to ensure applications undergo a neutral review process. These include training employees on the proper way to request additional information when it is needed to complete action on an application.

In addition, Treasury and the IRS, as noted, are drafting guidance on social welfare and non-social welfare activities of 501(c)(4) organizations as recommended by the Inspector General. Our goal is to provide guidance that is clear, fair to everyone, and easy to administer.

To ensure accountability in the determination process, the IRS has done a number of things, including requiring managers to conduct periodic workload reviews with their employees. Information on the average amount of time it takes to complete cases is regularly shared up the chain of command with me and other IRS leaders.

Our efforts to improve accountability also included centralizing exempt organization workforces so leaders now work in the same location as employees who process applications for tax-exempt status.

We have also taken actions to ensure risks are managed more effectively in the exempt organization area and throughout the IRS. We now have an agency-wide enterprise risk management program, providing for the regular identification and analysis of risks to be eliminated or managed across the agency.

To ensure we properly respond to requests under the Freedom of Information Act, we are developing standard procedures for employees to use when they search for information, and we will provide training to those employees on those procedures.

As recommended by both the committee and the GAO, we are tightening internal controls for the process we use to select tax-exempt organizations for audit once they are certified. Although the GAO recently found no evidence of unfair or biased audit selections, we agree with them that tightening the controls will reduce the risk that any unfair selections would occur in the future.

Another issue is the need for us to improve our records retention process. We have initiated a process to secure the e-mail records of all senior officials of the agency. In addition, we are taking steps to ensure that employees preserve official records created when they send messages using our Office Communicator System.

While we continue working to implement the committee's recommendations, we also appreciate the committee's bipartisan efforts on other critical issues. For example, the committee is considering identity theft legislation containing several provisions that would improve tax administration. These include accelerating due dates for information returns, allowing the IRS to require minimum qualifications for paid tax return preparers, and reinstating streamlined critical pay authority.

I would also urge the committee to consider two other important legislative changes: giving the IRS correctable error authority in limited cases and amending the Tax Equity and Fiscal Responsibility Act statute to simplify audits of large partnerships.

This concludes my opening statement, and I would be happy to take your questions.

[The prepared statement of Commissioner Koskinen appears in the appendix.]

The CHAIRMAN. Well, thank you, Mr. Commissioner. Again, I appreciate the way your agency has worked with this committee on our recommendations, but I also want to emphasize that there remain several open issues stemming from the targeting of conservative groups, and I want to get your response on two of those issues.

The first is, I understand that there is at least one group caught up in the targeting that is still waiting on a determination. Can you commit that your agency is moving with all appropriate expediency to resolve any remaining open applications?

Commissioner KOSKINEN. Yes, we will do that. I cannot, obviously, talk about any application, but we are down to just a handful. Several of those are in litigation. In some cases, we are still waiting for responses. But as I noted, we have reduced the backlog, and a new application today will get processed on average in that 112 days.

The CHAIRMAN. Okay. Secondly, in my opening statement, I mentioned the IRS and Treasury Department's 2013 proposal to restrict the free speech of certain groups of Americans by rewriting 56-year-old rules governing the activity of 501(c)(4) social welfare organizations. Now, the IRS subsequently withdrew them after widespread bipartisan opposition. I know we disagree on the need for changes to the rules governing (c)(4) organizations, and I know that

you have committed that no new rules will take effect before 2017. But this leaves open the possibility that the IRS will make proposals this year or next year, creating confusion and uncertainty regarding the free speech of certain groups and their ability to engage in civic activities like nonpartisan voter registration or candidate forums.

Can you tell the committee whether any new proposals will be released before 2017 and, if so, when you expect that to happen?

Commissioner KOSKINEN. We are, as I noted, following up on a recommendation of the Inspector General, who said that the “facts and circumstances” standard, which has been used for the last number of years, is confusing and was part of the problem employees had in interpreting the applications of determination from (c)(4) organizations across the spectrum. As you noted just before my confirmation hearing, draft regulations went out that generated 160,000 comments, all of them suggesting changes, many of them agreeing that, for instance, restricting the use of bipartisan/nonpartisan get-out-the-vote campaigns, candidate forums, things that had been done for years, should not be done, and we are taking those into consideration.

But it is clear to us that, in fact, what we are trying to do is not change the rules of the game. What we are trying to do is make them clearer for IRS employees and to have a clearer set of guidelines for those organizing these organizations and, most importantly, for those operating them. We think that, when you are running one of these organizations, you ought to be able to be confident that you know what the rules are, that nobody is going to come in afterwards and second-guess you on the basis of what their interpretation of the facts and circumstances are.

So I do think that the IG was right, that it would be important to clarify—not change but clarify—the rules under which organizations operate, and that is our goal and intent.

The CHAIRMAN. Can you tell the committee whether any new proposals will be released before 2017 and, if so, when you expect that to be?

Commissioner KOSKINEN. We do not have a timeline. We are continuing to finish our review of all those comments and continue to review the total statutory framework the Congress has set up. We have made it clear that we have no intention of influencing the next election. On the other hand, when we reissue the proposals in the new format that we think will be much more acceptable to people, they will be then open to public comment for 90 days. We have committed we will have a public hearing about it. We have committed we will keep the committees updated on the progress.

At this point, we do not have a timeline. We would hope that we would be able to provide these proposed new rules early enough next year so that the work on them could be completed well in advance of the election, so there would not be any confusion. But I would stress that the work that we are doing now is focused on clarifying—not changing, but clarifying—the rules under which organizations operate. So I think once we get those out, people will, in fact, on all sides understand much better what it is that we are talking about within the existing standards of operation. I think that clarity will benefit everyone.

The CHAIRMAN. Well, with the IRS unable to meet its basic duties of answering taxpayer phone calls and better protecting against tax fraud, I strongly encourage you to stop spending agency time on such controversial and counterproductive proposals.

Commissioner Koskinen, today you have mentioned several ways the IRS has adjusted its operations to serve taxpayers better and even more fairly. One area in which the IRS needs to continue to strive to do better is in protecting taxpayers' identifying information and the vast amount of financial and other information that the IRS maintains about taxpayers. The IRS also needs to do better in preventing Stolen Identity Refund Fraud.

You mentioned the regulation of paid tax return preparers, but I know there is concern that providing such authority could lead to more bureaucracy and potential harm to taxpayers.

Just one last question. Will you commit today that if the IRS were to be provided authority to regulate paid tax return preparers, the IRS will utilize the Circular 230 framework that is already in place and not create another new regulatory regime? And will you also commit to fully cooperating with this committee in its oversight role over the regulation of paid tax return preparers?

Commissioner KOSKINEN. I am happy to commit to both of those positions. We fully intend to use the 230 regulatory framework, and, in fact, if we were given the authority to require minimum qualifications for preparers, we would run it the same way we ran the program when we set it up in 2010, which was under section 230, the regulation 230. So we have no intention of expanding that, changing it. That program started off and looked like it was doing well until the courts ruled that we did not have the statutory authority. So the legislation you are talking about would simply make clear we have the authority to run the program as it was originally set up. So there will be no surprises. People will know exactly what it looks like, because that is what we did for almost a year.

The CHAIRMAN. Well, thank you.

Senator Wyden?

Senator WYDEN. Thank you very much, Mr. Chairman, and I appreciate your pointing out this question of the tax preparers, because this is another area that you and I have worked on in a bipartisan fashion with all of our colleagues.

On the question, however, of the 501(c)(4) rules, because this is an area where there has been, let us say, spirited debate, I think it is very much in the public interest that the agency clarify the rules for Americans to follow in elections. And I would urge you, as I did in my opening statement, to work with us on a bipartisan basis—you have heard me say that a couple of times this morning; that is what is so important—if you are going to come up with an approach that is substantively right and sustainable. So I urge you to do that and to work closely with us.

Chairman Grassley and I, Commissioner Koskinen, have been following these news reports about the question of the IRS cell phone tracking, and the press reported yesterday that the IRS obtained and received training for a Hailstorm cell-site simulator, a device which works by mimicking a cell phone tower in order to collect metadata from phones that connect to it. This comes on the heels of other news reports that many companies have taken to

tracking their employees' movements through cell phone trackers in order to avoid triggering a taxable presence in foreign countries.

Now, obviously the IRS has an important role to play in combating money laundering and drug trafficking and international tax dodging. My view, however, is that enforcement and protection of personal privacy must not be mutually exclusive. We have to have both.

So, Commissioner, what can you tell us this morning in an open session about the IRS's use of cell-site simulators?

Commissioner KOSKINEN. The use of that is restricted. It is our Criminal Investigation Division that uses that technique. It is only used in criminal investigations. It can only be used with a court order. It can only be used based on probable cause of criminal activity. What it does is primarily allow you to see point to point where communications are taking place. It does not allow you to overhear—the technique does not—voice communications. You may pick up texting, but I would stress it follows the Justice Department rules. It requires a court order, and it requires probable cause with regard to criminal investigations. It is not used in civil matters at all. It is not used by other employees of the IRS.

Senator WYDEN. How frequently have these investigations gone forward? In other words, how frequently are IRS criminal investigators obtaining location data about the people they investigate?

Commissioner KOSKINEN. I will have to get you that information. I do not know how frequent it is. I just know that it is used, as you note, primarily in cases of money laundering, terrorism, and organized crime.

Senator WYDEN. Can I have that answer within 30 days?

Commissioner KOSKINEN. You certainly can.

Senator WYDEN. Very good.

[The information appears in the appendix on p. 77.]

Senator WYDEN. On the recommendations that we are talking about this morning, I have tried to make clear that I believe the way the IRS handled the 501(c)(4) applications was an unmitigated disaster, using, in effect, ham-fisted methods for screening applications that basically let them just pile up for what seemed like eternity, and virtually none were processed. And certainly the agency made unacceptable mistakes in its response to congressional inquiries, particularly taking months to inform the committee when it discovered that Lois Lerner's hard drive had failed.

So I think I would like to start this morning—because I appreciated the letter that you sent to Chairman Hatch and me. In your view, what is the most important change that you have made in terms of responding to our bipartisan recommendations? What is the most important change and why?

Commissioner KOSKINEN. I think the most important change—and it is a combination of many of the recommendations—is to encourage and, in fact, require the free flow of information from the bottom of the organization to the top. What we are trying to ensure is, if there is a problem anywhere in the organization about anything, that employees feel empowered, in fact, feel responsible to note that problem, report it to their managers, and, if they feel that is not appropriate or they are concerned about that, to report it up through the organization. Our enterprise risk organization has its

own independent line of communication any employee can use. I have now talked to almost 17,000 IRS employees, telling them I want them all to view themselves as individual risk managers. I have an e-mail box that I have gotten about 1,000 suggestions from employees in. I have tried to get them to understand they should feel comfortable sending me problems, concerns, or suggestions.

I think if you look back at the problem, one of the problems that led to that inordinate and unacceptable delay was that the problem never moved all the way up the chain of command. It was, in fact, stuck in the middle. And also, the chairman mentioned structural change; it was because there were people in Cincinnati and people in Washington who did not have very good communication.

So if the communication works better, if there are regular reports of where the problems are, if there are issues where we know that applications are stuck, that information should be shared, not hidden.

Senator WYDEN. One last question for you, Commissioner, and it deals with the records and recordkeeping. Obviously, backup tapes were erased that should not have been, and though there is no evidence that the tapes were deliberately destroyed to hide evidence, now there have been some reports that employees did not own up to their mistakes when investigators came knocking.

What is the IRS doing to ensure that its employees in the future keep e-mails and records safe?

Commissioner KOSKINEN. Again, it is several things.

First of all, we discovered that it was, you know, a mistake that should not have happened, and it obviously did not help our response to the investigation. What we need to do is, when we have a document protection and retention request—what we learned is, you cannot rely on sending it out from the top in a large organization, 85,000 employees, and assume that it will automatically be transmitted accurately through to the bottom. So we have made it clear that, going forward, those retention requests will go individually through the chain of command.

Secondly, we are training our employees as to what it means to retain all media within a particular area. But the broader issue that we are dealing with is, we should not be depending upon individual hard drives and disaster recovery tapes as a backup system. Three years ago, the agency, because of budget constraints, made a decision not to upgrade our e-mail system. We are now actually doing that. We should have a standard—not, you know, some fancy thing—a standard e-mail system that retains the records automatically, that is easily searchable. We should not have to spend \$20 million in a year responding to legitimate congressional inquiries for information. So we need, in the short run, to make sure, whenever there is a document retention request, it goes throughout the organization and we are satisfied it goes down to the front-line managers and they understand what it means.

We also will provide training for the first time in terms of, for all the IT people, exactly the media that should be retained. In this particular case, again, it should not have happened, but the people on the front lines, the two employees involved—as the IG in his report noted, (A) nobody purposely did this, but, (B) this was viewed as junk. It was found in a closet. What we need to make sure is

that everybody understands, when we retain media, it is all media, wherever you find it, however old it is or however unusable it is.

And so we think going forward that will work, but the better solution in the long run is not to rely on backup disaster recovery tapes and not to rely on individual hard drives, but to, in fact, have a readily searchable backup system of all e-mail records of the agency.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Grassley will defer until after Senator Brown completes his questioning. Go ahead, Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

Commissioner, thank you for joining us today. I would like to shift the focus to something this committee had an opportunity to address last month but chose not to because of partisan infighting and the influence of interest groups in this town. It is the IRS's ability to regulate paid tax preparers. Congress has repeatedly been instructed that, in order to protect our constituents from identity theft, we must ensure that paid tax preparers perform due diligence, especially important and crucial for credits that assist low-income families, such as the Earned Income Tax Credit and Child Tax Credit principally.

As you mentioned in previous testimony, 57 percent of EITC returns come from paid preparers, three-fifths of whom receive no oversight from IRS. These preparers are not required to register with your agency. There are no qualification requirements that they must meet before assisting this group of taxpayers. It leaves an enormous hole within our tax enforcement infrastructure. IRS has estimated that 68 percent of EITC claimants turn to these paid preparers to help file their returns, likely because of the very complex eligibility requirements already placed within the tax code.

Paid preparers who do not enroll with IRS have an up to 40 percent higher chance of submitting an improper EITC return—not fraud, but an improper return.

Despite what some of my colleagues here might say about the IRS's inaction on this issue, the agency tried in 2010 to bring these preparers in line with minimum qualification standards. As you know, the DC Circuit Court overturned the effort and instructed Congress that it is actually our responsibility to provide your agency with the authority to do this.

Last month, when attempting to correct this problem, some of my colleagues balked at the idea of granting your agency this crucial authority, and here is my question—or a couple of questions.

Walk us through, if you would, why it is so important for Congress to take action and to help improve tax enforcement for this group of taxpayers. And I know, since 2010, you have taken steps to increase compliance and reduce error rates. So if you would, as you walk us through the whole idea of why it is important for Congress to take action, integrate into your comments what you have done since 2010 and the steps you have taken.

Commissioner KOSKINEN. Well, as I advised the chairman, what we are talking about, as you note, is just requiring minimum qualifications of preparers. We are not talking about any massive regulatory regime. It is simply that people ought to demonstrate a minimum capacity to understand the tax code. It is particularly impor-



tant in low-income and immigrant areas where a lot of times people are hanging out shingles saying, "Come with me, I will get you a bigger refund."

I would stress the vast majority of tax preparers are honest and try to do a good job. And, in fact, we do tax forums; we handled over 10,000 return preparers who came and spent several days with us updating themselves.

So what we are proposing is simply, again, what we started to do and ran for almost a year, which is requiring just minimum continuing education, minimum qualifications for tax preparers, particularly in areas like the EITC where, as you note, the majority of EITC returns come from preparers, and a significant number of those are erroneous simply because the preparers do not have a real understanding, have had no education, about how the program and how various credits work.

So we think it would be a significant step forward and provide greater protection to taxpayers, especially in low-income areas, to have some level of confidence that when they pay a preparer to prepare that return, the preparer has some knowledge of the tax code rather than is just somebody who hung out a shingle, somebody's brother-in-law, somebody at a community center, who says, "I will fill out your returns for you." Some of them are unethical. Some are crooks who say, "Come with me, I will get you a big refund." Sometimes some of them are actually collecting the refunds themselves.

Now, we are not going to get crooks out of the world, but basically if people take the time to become educated to some extent about what the tax law is about, it is a better indication that they are serious about doing it well.

The EITC rate of improper payments and the volume of improper payments is the single most intractable problem we deal with. We have a significant problem with identity theft, but we have just created a new partnership with the private sector and State tax commissioners, and we are making progress on identity theft. But we need more tools. I appreciate the committee's support for getting W-2s earlier so that we could, in fact, match the W-2s with the returns that we are getting. We need access to the new hires database, which this committee would provide us with.

It is a complicated problem. Ultimately, it goes to, as you point out, the complexity of the eligibility requirements in the statute, and, while the statutory framework is not my domain, if it were simpler, that also would help.

Senator BROWN. Thank you. And, Mr. Chairman, thank you, and especially again, thanks to Senator Grassley.

One really quick comment. In Senator Portman's and my State, United Way has played a major role in staffing and running Volunteer Income Tax Assistance sites, which have made a difference.

Just one last really brief question, and you can pretty much answer "yes" or "no." If we were to take some of these actions that you asked for, I assume you could say with some certainty that improper payments—some would call it fraud; it is clearly not fraud, but improper payments—the rate of them would be reduced.

Commissioner KOSKINEN. Yes. What I did when I started was, knowing this was a problem, I said I wanted everybody in this

agency who knows about this problem and has been working on it, to sit down and say why is it we have not made more progress over the last 10 years. It is not for want of trying. We have tried a range of things. And I said I wanted it to be a blank slate. Just tell me what would we need. And what came out was, what we needed would be to have the ability to require minimum qualifications; we would need W-2s earlier; we would need access to databases that would allow us to double-check what goes on; and the final piece which I asked the committee to consider is, we need limited correctable error authority. We can see in returns when somebody has claimed erroneously a child, but we cannot correct that. Under the statutes, we have to send a notice, we have to audit those people, and there is a limit to our ability to do that. We can do math error corrections, and the correctable error authority would simply allow us to—in educational tax credits, for instance, if you went to a university not on the list, if we see that, we either have to hold the return and deny you the credit and audit it, or we have to let it go through. And we do not have enough resources ever to audit our way out of this problem alone.

So that package was what I was told a year and a half ago, and that is why we have been working with and appreciate the support from the committee on all of those areas. If we had those, we think we would make a significant dent in the improper payment rate, a significant dent in the volume of improper payments that are made under, not only the EITC, but the educational tax credit and the additional child tax credits.

Senator BROWN. Commissioner, thank you. And I hope, Mr. Chairman, we can work together on that as we negotiate tax issues and extenders and all that is ahead. Thank you so much.

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Thank you very much for holding this very important hearing. It is evident from the report that, at the very least, a dysfunctional culture and poor management led to the mistreatment of groups with a conservative philosophy applying for tax-exempt status. It is clear to me from the report that political biases and poor management went hand in hand with politically motivated behavior continuing unchecked.

The targeting scandal, coupled with poor customer service and general mismanagement, has shaken what confidence taxpayers had in the IRS. To move beyond this, Congress and the IRS are going to have to work together to make the necessary changes to ensure similar abuses can never happen again.

So I think the time is right to once again revisit the issue of taxpayers' rights and IRS structural reforms. The bipartisan report has a number of good recommendations, and, in addition, I want to remind my colleagues that Senator Thune and I introduced the Taxpayer Bill of Rights Enhancement Act to further beef it up.

I have three short questions. Mr. Commissioner, for taxpayers to move beyond the targeting scandal, they need to know that those who allowed it to occur have been held accountable. My understanding is few, if any, disciplinary actions were taken against mid-level managers who were directly involved in the improper targeting. The bipartisan report details one such manager who was

not only never disciplined, but received a bonus and has been promoted.

So my question: how can taxpayers applying for tax-exempt status feel confident they will be treated fairly when individuals who oversaw the targeting remain in place, were never disciplined, and in some instances even promoted?

Commissioner KOSKINEN. I would note a couple things, Senator.

First, as I noted in my testimony, the chain of command, starting with the Commissioner down five levels, all those are new. All of those have been changed as a result of this.

Secondly, as the Justice Department noted, they interviewed 100 employees and found no evidence that any employee actually acted with regard to political bias or discrimination. So there is not a finding in the recommendations in any of the reports that an individual exercised political bias in selecting applications for review.

Nonetheless, as I have stated from the start, it is a situation that should not happen. People should not wait 2 years. The categorization was erroneous. But in terms of discipline, as I say, the chain of command all the way down has changed. There are new people who have gone through, and we have pursued appropriate disciplinary review as needed. But I would note—and I think it is important for the public to note—that the Justice Department, as I say, talked to 100 individuals, some of whom identified themselves as conservatives and Republicans. None of them indicated that anyone had done anything based on political bias.

Senator GRASSLEY. Okay. A follow-up then to something that Senator Wyden discussed with you about the cell-site simulators. The follow-up would be: in the past 2 months, both the Justice Department and the Department of Homeland Security have publicly issued policies that require greater Fourth Amendment protections and greater transparency when these devices are used. So my question is whether or not you could commit to issuing such a policy statement by a date certain.

Commissioner KOSKINEN. We actually follow—as a regular matter, our criminal investigators follow the Justice Department policies, and if they are updated, we follow those. And I am happy to commit that we will follow that Justice policy.

Senator GRASSLEY. Okay. My last question: this bipartisan report that we have referred to was significantly hampered by poor electronic record retention. My understanding is that the IRS has been working with the National Archives and Records Administration to implement a record management approach known as “Capstone” and come into compliance with an executive directive mandating e-mails be managed in an accessible electronic format at least by December 31, 2016.

Two questions. Does the IRS expect to be in full compliance with the executive directive and Capstone procedures by December 31st next year? If not, why not? And what procedures does the IRS have in place presently to ensure that what happened with Lois Lerner’s e-mails does not happen again in the meantime?

Commissioner KOSKINEN. We will be in compliance. In fact, we are almost there now. We have the top 350, 400 senior executives, their e-mails are all now separately catalogued and preserved. As I noted, our goal is to, in fact, not depend upon hard drives and

individual computers, not depend upon disaster recovery tapes as a backup system, but to automate our e-mail system, upgrade it to what everybody else is using, so that we have not only a backup system separate from the normal e-mail systems, but also one that is easily searchable and readily searchable. And we are moving in that direction. As noted, we have a plan that we have worked with NARA on, and we are in compliance with that plan and the timeline. And by the end of next year, we hope not only to beat the Capstone issues but to be moving even with limited resources toward upgrading our e-mail systems so that we never have this problem again.

Senator GRASSLEY. Thank you very much.

Senator Wyden [presiding]. Senator Scott is next.

Senator SCOTT. Thank you, Mr. Ranking Member. Good morning.

Commissioner KOSKINEN. Good morning.

Senator SCOTT. Earlier, Senator Wyden asked you a question about the most consequential change you have made at the IRS in response to our report. I think your answer was, your employees can now e-mail you in a new special e-mail box that was just created. That was the most consequential thing you have done based on the report?

Commissioner KOSKINEN. I think what I said was, the most consequential thing I have done is tried to get every employee to view themselves as a risk manager. If they see any problem they have any issue with about any question, they should immediately report it to their managers. If they have any concern that it is not going up the chain of command, they should report it either directly to our risk management office, or they should report it directly to me. So they have an open line of communication.

We have done a whole range of things. My testimony is full of those that we have adopted. I do think that ultimately for us to avoid these kind of problems, we need to have a situation where no problem gets hidden—

Senator SCOTT. Got you.

Commissioner KOSKINEN [continuing]. No problem gets ignored, no problem moves up—

Senator SCOTT. I am going to move on to my questions, but I do believe, as I listened carefully to your answer, the answer that you gave, though your testimony is filled with recommendations and suggestions, based on your limited ability to move forward without legislative action, the most consequential change you have made is that there is a new e-mail system in place where your employees can directly e-mail you.

Commissioner KOSKINEN. I think that is an improper characterization.

Senator SCOTT. Okay. Good enough for you.

Here is a question for you. Why are we here? I think it is very important for us to remember why we are here having this conversation or having this hearing. It is because in the IRS, an agency in the Federal Government with amazing power of intimidation, there was, has been, and hopefully no longer is, a culture of discrimination, a culture of discrimination that focused and targeted conservative organizations, Tea Party and other conservative groups, 300-plus, and in addition to that, also audited individuals

who were making conservative contributions. So we are here today not to have a conversation about simple structural change. We are actually here today because there was a culture of discrimination in the agency that has the power of intimidation in a way that no other agency in the Federal Government has, and it used that power of intimidation against conservative organizations, and then there was a cover-up of that intimidation. That is why we are having this hearing today.

If you think about the fact that those conservative organizations cumulatively waited nearly 600 years—600 years—to receive an IRS determination, we should seriously consider what actions are necessary for us to make sure that culture never again exists.

You were brought in as a turnaround man, to turn this around. And as Senator Grassley asked, who has been fired? What are the disciplinary measures that you have taken? Do you have the power to fire the employees who were involved? Because we know that we have the power to promote some of the employees because, obviously, some have been promoted, as Senator Roberts has clearly stated earlier. I am concerned, as a taxpayer, with the breaches that we have had, that the new culture is a culture that is still as inconsistent with the right direction as the old culture. And my concern for the 8,000 South Carolinians who have had their information exposed because of the breach is just on top of the concern that I have for this culture that seems to target individuals based on this notion that America is a Nation of free speech, and if they do not like it, there is someone in the IRS who can tamp it down. That is a problem from my perspective that we should pay close attention to.

And then, Mr. Koskinen, you mentioned in your opening statement that there are limited resources. My question is: if there are limited resources, as the turnaround guy, should you ask for the ability to take the employees, the 200-plus employees who are working full-time on union activities, should you take the 600,000 hours—the 600,000 hours—invested yearly on only union activities, should you redirect, if you had the power, the \$27 million of taxpayer resources in a different direction so as to meet the obligation of the IRS as it relates to actually dealing with taxpayers? And, if you do not have that authority, and I am sure you do not have all the authority, should a part of your response be asking for the authority? Because perhaps we need the legislation that would empower you to complete the job as the turnaround guru that I am sure you could be. And, if you need that legislative action, tell us what it is so that we can work with you in making sure that the IRS is the premier agency within the Federal Government that emboldens people to have great confidence in the outcome and in the process. I would love to partner with you in that journey.

Commissioner KOSKINEN. If I could respond—

Senator WYDEN. Briefly, Mr. Commissioner. Senator Roberts is next.

Commissioner KOSKINEN. Can I respond to—

Senator WYDEN. Sure; of course.

Commissioner KOSKINEN. First, I appreciate the offer of support. It is important to ensure the public has confidence.

You mentioned, as a fact, the culture of discrimination. There is no evidence that supports that there was any culture of discrimination. As noted, the Department of Justice interviewed 100 different employees of the IRS, some who identified themselves as conservatives, some as Republicans. None of them said that political bias had entered into any decision.

In terms of individual audit selection, anyone who has claimed to be targeted, the Inspector General has looked at over 100 of those cases and has found not one where anyone was “targeted” because of their political activity. So we need to deal with the problem, but we need to characterize it appropriately.

The committee in a bipartisan way listed a set of recommendations they thought would deal with this problem. We have committed to implementing all of those recommendations within our control. We remain committed to making sure that the situation does not happen again. Groups should not have to wait for 250 or 500 days to get certifications. And, in fact, it should be noted, which we sometimes forget, you can set up a (c)(4) organization and go into operation without the approval of the IRS, so that anyone who wants to set up tomorrow morning or wanted to over the last several years to become a (c)(4) could do that on their own without our approval.

Part of the reason they need or seek our approval is because the rules are complicated in terms of what the facts and circumstances are, and they want to be able to have us review that in terms of facts and circumstances, which is why I think, if we could clarify and not rely on “facts and circumstances,” it would be much easier for those interested in becoming (c)(4) organizations to set up and operate with confidence that the rules are clear and that nobody is going to second-guess them.

Senator WYDEN. Thank you, Commissioner.

Senator SCOTT. Mr. Chairman, I do need to respond to what he said, if you do not mind giving me 30 seconds. I would appreciate it very much.

Senator WYDEN. Very briefly.

Senator SCOTT. In a document cited at the top of page 153, Lois Lerner compares the approach that led to getting Al Capone to using audits to intimidate tax-exempt organizations. Lerner’s improper intervention into the audit process is described in section II(C)(5)(b) of the Republican views. Examples include how Lerner may have directed audits of Crossroads GPS, a group affiliated with Ms. Palin.

Thank you, Mr. Ranking Member.

Senator WYDEN. Okay. Senator Thune?

Senator THUNE. Thank you, Mr. Chairman, and I want to thank you and Senator Hatch for holding this very important hearing. It has been, as has already been noted, 2½ years almost since the Finance Committee opened its bipartisan investigation into the IRS’s targeting of social welfare groups based on their conservative political views. I think the question we have to ask at this point is, “What have we learned?” Well, certainly that the IRS was guilty of gross mismanagement or, in the words of our ranking member, “vast bureaucratic dysfunction.” But I believe we do the American people a disservice if we attribute the inexcusable behavior of IRS

employees simply to incompetence. To do so would ignore the fundamental problem at hand: the fact that the culture at the IRS allowed employees to believe that they could let their personal political views guide how they treated taxpayers, and that there would be no repercussions whatsoever for doing so.

Simply put, we need a cultural change at the IRS. American taxpayers should expect at the very least a culture of accountability, a fairness, an impartiality. No taxpayer ever again should fear that they will be discriminated against based on their political or ideological beliefs.

And so, while I appreciate the changes the IRS is attempting to implement on their own, I believe that more needs to be done. And earlier this year, Senator Grassley and I introduced the Taxpayer Bill of Rights Enhancement Act of 2015, which is a series of measures to hold the IRS accountable to American taxpayers. Unfortunately, the IRS has lost the trust of the American people, and it does not have the credibility to make the necessary reforms on its own. And I believe that the Congress needs to act to ensure that taxpayers' rights are protected and that there are real consequences when they are abused. And I hope that this committee can count on the support and cooperation of you, Mr. Commissioner, and other high-ranking officials at the IRS and Treasury as Congress considers new taxpayer protections.

And with that, what I would like to do is get your views on a few of what I think are the common-sense proposals that Senator Grassley and I have in our legislation to make the IRS once again accountable to the American taxpayers. And I am going to read through these and ask you to hold off on commenting until I get to the end. And if you cannot address these, you can answer them for the record. But I want to get these questions in.

The first one is that last year the IRS proposed its own Taxpayer Bill of Rights, and the question is: would you support legislation to codify these rights and to make it the official duty of the IRS Commissioner to ensure that IRS employees are familiar with these rights? So that is question number one.

Second is, the Ten Deadly Sins created by the IRS restructuring commission in 1998 require mandatory termination of an employee who threatens to audit a taxpayer for personal gain. Would you support amending the Ten Deadly Sins to include threatening to audit or failing to perform an official action for political purposes? So that is question number two.

Number three, in your recent letter to the committee, you stated that the IRS failure to preserve electronic records such as e-mails is clearly unacceptable, and you noted that the IRS is implementing records management improvements. Do you support legislation that would ban IRS employees from conducting official business over personal e-mail, a measure that passed the House by a voice vote earlier this year? And also, do you support legislation that would codify the deadline by which the National Archives has required the IRS to put updated document retention policies in place?

Finally, and the fourth question, keeping in mind that some conservative groups were stuck in limbo for up to 5 years on their applications, would you support granting 501(c)(4)s the ability to file

for declaratory judgment on their application if the IRS has not acted upon it after 270 days? And as you know, that is something that 501(c)(3)s already possess and access as a remedy.

All of the measures I just mentioned are included in the Grassley-Thune Taxpayer Bill of Rights, and, as I stated earlier, I hope that we can count on your cooperation on these measures and others that the committee might consider to restore the credibility and the integrity of your agency.

So I say all that, ask those questions, and you maybe can keep track of all that, but to the degree that you can, comment on those, Commissioner, and then if you cannot, we will certainly welcome that for the record.

Commissioner KOSKINEN. I would note, when you note the changes on our own, the changes on our own are the changes in response to the recommendations of the bipartisan report as well as recommendations in the majority and minority reports. So these are not ideas that we have just by ourselves. We have said we will implement all of the recommendations we have control over that this committee has recommended in its report are necessary to make sure that the delays do not happen again. So it is not just us. We are actually doing everything you asked us to do.

With regard to the Bill of Rights, as you noted, we pulled together the Taxpayer Bill of Rights over a year ago. We spent a lot of time trying to make sure taxpayers and employees are aware of those. They are already codified in statute. That is why we pulled them together, so that they would be in one place. And we do think it is important for those to be—we provide training on them for the employees. We think it is important for taxpayers as well as employees to know what those are. Codifying those and saying those are a Bill of Rights would be codifying the rights that exist throughout various statutes. We would be delighted to support that those become an important part of the statutory framework, because they already are. What we have done is be able to make it easier for taxpayers to find them.

With regard to official business on personal computers, that is a policy we already have. You are not supposed to do that. In fact, when I first started, I sent testimony home one day to my home computer so I could edit it, and then the next morning I got a note saying, "You are not supposed to do that." Somebody came to my office and said, "We assume you are editing testimony." I said, "That is right." The next thing I got was an office computer for home so I would not, in fact, send anything to my home computer. So that is a policy that we have and enforce very stringently. It has security issues associated with it. It is a policy. If you wanted to put it in legislation, we would be happy to have you do that. I am not sure we need a lot of new rules for those things.

Otherwise, I would be delighted to get back to you. I think that clearly it is impermissible for anyone to use their political beliefs in doing any business at the IRS. I do not know what most people's political beliefs are at the IRS. And I would simply note again—I know Senator Scott feels strongly about this—that the Justice Department talked to 100 IRS employees, several of whom self-identified themselves as conservatives and Republicans. No one identified a single instance in which they were instructed to or in



which they knew of anyone who took an action because of their political beliefs. Lois Lerner clearly had very public beliefs. Those beliefs she is welcome to have in her personal life. They have no place and no role in the operations of the IRS. And I do not know of any other situation or indication. And even people who did not like Lois Lerner and did not approve of her management talent, according to the Department of Justice, did not feel that those views had influenced the decision—

Senator WYDEN. Colleagues, we are going to have to move on. Senator Roberts?

Senator ROBERTS. I want to thank Chairman Hatch and Ranking Member Wyden, and thank you for this hearing and our committee's report on the IRS actions.

With regard, as stated by others, to the suppression of electoral activities of groups whose views do not coincide with those of the White House, having gone over the report, it is clear this was a massive effort. And I remain deeply concerned and, worse, have no confidence that we will have all of the information we need to make a final determination on the IRS activities, and more important, safeguards to protect these groups' First Amendment rights. It is very clear, as has been said by Senator Wyden, from the report that there was gross mismanagement of the exemption application process for these targeted groups. In fact, the committee agrees that, at a minimum, there was a heightened scrutiny of applications from certain organizations and that this scrutiny resulted in significant delays in processing applications, which in some cases caused the applicants to simply cease operation.

The committee also found by a bipartisan agreement that the agency functioned in a politicized environment and that this environment allowed for the improper processing of applications from the targeted organizations.

The agency looks to have dropped any pretense of impartial tax enforcement, actively worked against conservative groups, and coordinated with the White House and other Federal agencies, including the Department of Justice and the Federal Election Commission, to suppress electoral activities of groups whose views do not coincide with those of the White House.

In my reading of the factual information presented in the report, there was a systematic suppression of free speech rights of these organizations which I think is, sadly, ongoing. The end result has been an egregious loss of faith in the agency, as has been pointed out by Senator Scott, Senator Thune, and others. This is an abhorrent situation compounded by the agency's half-hearted efforts to locate and preserve records relevant to the committee's investigation. In fact, the IRS saw fit to mislead the committee about the existence of backup data and sat on the information about computer crashes and lost backup tapes for weeks.

Now, Mr. Koskinen, you have been on board in this decay of the reputation and standing of the IRS. You bear a direct responsibility, which you obviously have said, particularly in your less-than-cooperative approach in responding to the oversight requests of this committee.

Now, to be fair, as you have said, I know you have taken a number of steps to address some of the issues and recommendations

identified in our report. These appear process-oriented and very technical. At least we have this. You are talking about delays. We are talking about targeting. But, without question, there is much more that we can do. There are some very common-sense structural changes we should consider. Chairman Hatch, Ranking Member Wyden, Senator Grassley, and others have given us a full legislative prescription.

Now, we have a number of other sound ideas that have been offered by committee members, including legislation by Senator Coats to provide a legal right of action when (c)(4) applications are delayed; Senators Grassley and Portman's Taxpayer Bill of Rights; Senator Portman's on gifts to (c)(4)s; Senator Cornyn's small business protection proposal; and my legislation with Senator Flake to put a stop to further action on the (c)(4) regulation rewrite. I would like to see a real rewrite that could take care of the politics part of this as opposed to what might be ongoing.

These are all good first steps in reorienting the IRS away from a political posture. I look forward to working with my colleagues and you, sir, as indicated by Senator Scott, through the committee as expeditiously as possible.

You have just stated that the Justice Department interviewed 100 folks from whom there was some suspicion of targeting groups on a political basis, and not one—not one—was involved in any politics. Senator Scott just alluded to this in South Carolina and in Kansas. I find this incredulous, because the people I talk with have been targeted, and targeted for years, and it is without question a situation where politics was involved.

So, given the remarks of Senator Scott and given the remarks of others—and you have gone over a disciplined review effort at the IRS—and given that American citizens were targeted for extra scrutiny in the exemption application process, thereby denying them the First Amendment right, as so eloquently stated by Senator Scott, a tactic that I think is comparable to what is seen in a totalitarian country, take your pick—take your pick—has anyone involved in this targeting been fired, fined, reprimanded, denied a bonus, slapped on the wrist, or even talked to in a stern manner?

Commissioner KOSKINEN. As I said in response to Senator Scott, I respectfully would disagree with the characterization of what the situation at the IRS is. The IG, the Department of Justice, and GAO have all looked for instances of political bias actually targeting anyone, and none of those reviews has come up with a single case.

Clearly, I do not mean to minimize at all the delays, the mismanagement that took place from the start. We have apologized to people for those delays. It should not happen. But continuing to characterize it as if there is a politicized atmosphere and that is causing a lack of public confidence—if we say that enough, there will be a lack of public confidence. The independent investigations that have looked at that have not found a single instance of that.

It does not mean we do not need to take the actions. You have a bipartisan report after 2½ long years, which is, I think, terrific. We responded quickly. We think the recommendations you recommended to us that we have control over are important and thoughtful, and we are going to implement them. And our hope is

that our response positively to the committee will, in fact, restore whatever confidence has been lost. But I would say that, again, just reiterating, I think it is important for the public to understand that, while people may feel they were targeted, there has been no objective review that has found that to be true.

I do think it is corrosive to the tax compliance system if people feel that way. We are doing everything we can to try to assure taxpayers that when they hear from us, it is because of an issue in their tax return or their application—

Senator ROBERTS. Well, I thank you for that—

Commissioner KOSKINEN [continuing]. And it has nothing to do with who they are.

Senator ROBERTS. Excuse me. My time has run out. But I thank you for your very optimistic take on this, and I think I probably would agree that, with the people I have talked to who are very irate about this, it tends to be anecdotal evidence. And you have stated that the GAO, the Justice Department, and Lord knows how many other people, have investigated this with over 100 folks and found absolutely nothing wrong. That is just not the case with regards to people whom I know in Kansas who have been targeted and—not only targeted, but also audited. I just find that rather incredulous that these two things do not match up.

Commissioner KOSKINEN. Well, let me just make one point, if I could, Mr. Chairman, because I think it is important. As I noted, even with limited resources, we will do a million audits this year. We will audit Democrats. We will audit Republicans. We will audit independents. We will audit conservatives. We will audit people who go to church, people who do not go to church.

Senator ROBERTS. You will probably audit some members here.

Commissioner KOSKINEN. Right. And all of those people will be selected by objective criteria. The GAO has reviewed that with us. All of them need to feel that the only reason they are hearing from us is because of an issue in their return.

Senator ROBERTS. But that was not the case with Lois Lerner. It just was not. It just was not. And now she has been cleared, and she is just collecting a pension, which gets back to my question. Has anybody involved in this been fired, fined, reprimanded, denied a bonus, slapped on the wrist, or even talked to in a stern manner?

Commissioner KOSKINEN. The entire—

Senator ROBERTS. You are just saying everything is fine—

Commissioner KOSKINEN. I am not saying everything—

Senator ROBERTS [continuing]. And it is not fine.

Commissioner KOSKINEN. It is not fine, but it is not the problem of political targeting. It is a problem of, in fact, the recommendations you make and the recommendations we are implementing. We need to have a better operation to ensure it does not happen again.

Lois Lerner had political views that she had a right to. She had no right to have them expressed during her working hours. The Justice Department talked to, as I say, 100 employees—

Senator ROBERTS. All right. I have heard that.

Commissioner KOSKINEN [continuing]. And found no case where—

Senator ROBERTS. I have heard that.

Commissioner KOSKINEN [continuing]. They were influenced by her views, and I think it is important for us to understand what the facts are. I would not minimize the inconvenience, the impossible, the unacceptable way that the applications were delayed. There is no reason for that. We are committed to lowering that cycle time. We are down to 112 days. We are comfortable with the 270-day—

Senator ROBERTS. Mr. Koskinen, my time is up, and that means your time is up right now. I admire your tenacity, and I admire your position. There is a great organization that you ought to take part in here in Washington that is called the “Flat Earth Society” with regards to whether there was any politics in this or not.

Senator WYDEN. Mr. Chairman, several colleagues have now made the point about targeting and political bias, and just with your indulgence, colleagues, I want to just very briefly respond.

The Inspector General’s audit that spurred our inquiry found zero evidence of targeting or political bias. So what we did, because we thought it was important to be bipartisan, we sent our investigators to ask every IRS employee directly involved in the review of applications whether there had been any attempt to do this targeting to exert partisan influence. Not one employee—not one—said there was any political bias. You all have heard me characterize this whole effort as one involving massive bureaucratic dysfunction. But there is no evidence of political bias.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, I think you would have to be nuts to read this and not conclude there was political bias. My gosh, Lois Lerner herself—Lois Lerner herself—I do not care what the left says about it. We all know there was political bias.

Senator WYDEN. Mr. Chairman—

The CHAIRMAN. We all find fault with Lois Lerner, and we ought to find fault with her.

Now, was it criminal work? I do not know. They say “no.” I accept that.

Senator Heller?

Senator WYDEN. Mr. Chairman, just before we go to Senator Heller, our investigators, our bipartisan investigators—this is not somebody else; this is our people—talked to every employee, and they said “no political bias.”

The CHAIRMAN. I do not think our side said that.

Senator Heller?

Senator HELLER. Mr. Chairman, thank you, and to the ranking member also, thank you very much for holding this hearing. I want to thank the ranking member also for following up on this cell phone tracking issue of the IRS and hope that you do not take today’s response as an answer. I would anticipate they would have one rogue member of that IRS group who could take an issue like this and expand it far beyond the scope of what it was initially intended for.

But having said that, Mr. Chairman, Commissioner, thank you very much for being here, and thanks for taking your time. I know some of these are pretty strong comments, and they are not going

to stop with me. But I do also understand that this is the purpose of this hearing today. So we will continue that.

With the report on the IRS targeting certain conservative groups and the recommendations from this committee, there is a lot of concern that I am hearing from people back in my State, and I believe we have an obligation to the American people, also to Nevada taxpayers, to ensure that the IRS lives up to its mission of providing, I think as you defined it, top-quality service and also enforcing the laws with integrity and fairness to all. I know you do not disagree with that and live by that as much as you can, but right now, the way I see it, the IRS is not living by those particular standards.

To say that I am disappointed with Friday's political decision that the Justice Department would not seek criminal charges against Lois Lerner or anyone else for the IRS controversy is an understatement. It is unacceptable that a government agency has yet to take action against mid-level managers and an administration that refuses to hold accountable employees who use their political influence to impact daily operations of the IRS.

Commissioner, you have been there for several years now—actually 2 years in December. Congratulations.

Commissioner KOSKINEN. It seems like longer.

Senator HELLER. I bet it does. And I know you do believe that you are ultimately responsible and accountable for these actions. So I have a couple questions for you.

I will start by saying that the public trust, I think we would agree, is critical to the IRS's success. In my home State, I continually hear from Nevadans questioning why they should have faith in your agency and, frankly, the Federal Government period. You have made statements in the past about your agency. This is a new day. This is not the IRS of 2010, 2011, or 2012. And I find it hard to explain why Nevadans should trust the IRS when the agency, former Commissioners, and yourself have continually misled both Houses of Congress about whether it targeted conservative organizations.

Your agency has also stonewalled Congress's investigation by repeatedly failing to preserve and locate records, made inaccurate statements about the existence of backup data, and failed to disclose to Congress the fact that records were missing.

As I said, I believe you do feel you have a personal responsibility for these failures. Do you feel that way?

Commissioner KOSKINEN. I certainly am responsible for everything that goes on in the organization. I have told employees that if there is a problem, it is my problem; if somebody has made a mistake, it is my mistake; and I am comfortable, being in charge, with that.

I think the issue has been raised about the delay in disclosure about the hard drive crash of Lois Lerner. At the time, when I was advised in April of 2014 that there was a crash, it seemed to me the appropriate thing to do was to determine what e-mails had been lost and what e-mails we could find. We found 24,000, and we reported that to the committee. But people have been concerned about the fact that I knew in April and we did not provide the full report until June, which I thought was the right thing to do. But since then, we have taken the position that if there is an issue like

that while we are investigating it, we will advise the committee and the public. We did that with the Get Transcript breach. We did not know the full sweep of it, but we immediately let the chairman know and the ranking member know that we had a problem, we told them what we knew about it, and we continue—

Senator HELLER. Do you believe the IRS broke any laws in not backing up her e-mails, Lois Lerner's e-mails?

Commissioner KOSKINEN. I do not think we broke any laws. We had an antiquated system. There is no reason to rely on individual hard drives, no reason to rely on backup recovery tapes as your backup system. We had an antiquated system, and a decision was made in 2012, for budgetary purposes, not to upgrade it. We should have done that even with budget constraints. We would have avoided a lot of these problems.

Senator HELLER. Let me ask a question for the third time. I know Senator Scott asked this question and Senator Roberts asked this question. It has not been answered yet. Have there been any staffers directly involved in the tax-exempt targeting scandals who have been fired?

Commissioner KOSKINEN. I cannot talk to you about individual cases. I can—we will be happy to talk to you in private. We are just not allowed publicly to talk about it. But what I can say publicly is, the entire chain of command, five levels of supervisors from the Commissioner on down, are no longer there.

Senator HELLER. No longer with the agency or no longer in their current positions?

Commissioner KOSKINEN. They are no longer with the agency. They have all been—they have all left, and I can give you the details of how that happened, but not in public.

Senator HELLER. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Coats?

Senator COATS. Thank you, Mr. Chairman and Ranking Member. Mr. Koskinen, obviously you have heard about the continued frustration that many of us have had. It is no secret there has been a loss of trust in government. It is not just your agency, but it is many agencies. It is the function of government and its leadership. It is reflected in the primaries on both sides. People are just disgusted and fed up with our dysfunction. You have talked about massive dysfunction within an agency that people fear the most, that has the most power over individuals. It is not going away. And so, whether it is just incompetence or total dysfunction or the fact that government has just grown to the point where it simply cannot handle the issues that it needs to handle and gain the trust of the American people, my colleagues have stated that—and I certainly think—there is no other agency that more fed into that narrative than what happened at the IRS.

There is no trust in the Department of Justice either. The former Attorney General appeared to be nothing more than a private counsel to the President of the United States, and the decisions that came out of there did nothing to restore that trust.

Having said that, I want to go to a specific issue here. An Indianapolis investigative reporter brought this to my attention. We followed up on it, and I want to see if you can address this issue or

are in the process of addressing this issue so that it does not happen again.

My understanding of this is that, while the IRS takes identity theft seriously when it involves significant tax fraud, it does not do so when names and Social Security numbers are stolen in order for an undocumented worker to get a job. A live example of this, and there are other examples, happened to someone in my State, and it was brought to my attention by this investigative reporter.

An undocumented worker might submit a tax return using his own Taxpayer Identification Number, but attach a W-2 form to it with someone else's name and Social Security number. And when the IRS discovers this, as you should, the legitimate taxpayer's account gets an identity theft indicator put on it. But the return that has been filed with false information is still processed, and the perpetrator suffers no ill consequences.

In the meantime, it can cause a nightmare for the legitimate taxpayer who might get harassed with IRS letters accusing them of not reporting income. They may even lose income-related benefits. And as I said, one taxpayer could not get health insurance for his children for several months because he was a victim of this kind of identity theft.

The question I have is this. Is the IRS aware of this issue? Is it taking steps to address this issue? If it is prohibited by law from taking actions to stop this fraud, we need to know that so we can modify that law. But the issue is that the IRS discovers employment-related identity theft and still processes the tax return that used the false information and sends any refund to the perpetrator, it does not link the account of the filer who submitted false information with the account of the victimized taxpayer, nor does it mark the account of the perpetrator in any way. The IRS does not inform the employer that the worker submitted a false name and Social Security number. It does not notify law enforcement that the filer submitted false information in order to obtain employment. And my question is, can we fix this, if you are aware of it? And if you are not, can we work together to fix this?

Commissioner KOSKINEN. It is an important and complicated situation, as you can imagine. As a general matter, the use of Social Security numbers for employment purposes, the INS and Social Security pursue. Our role as tax collectors is—there are a lot of immigrants here, whether they are illegal or they are just not documented, undocumented immigrants who work, and they also all want—not all—many of them want to pay taxes because, if there is ever an amnesty, they have to demonstrate they have paid them. So they actually get an ITIN, which they use to file, and for us that is sufficient, and they file, and we do fine with it.

The use of—sometimes it is relatives', sometimes it is borrowed, sometimes it is stolen—Social Security numbers to get the job so that an employer actually does a W-2 is a process that, again, the INS and Social Security pursue. Our job is, if somebody wants to pay taxes, if they want to be compliant with their tax obligations, even though they have citizenship challenges, our job is to collect those revenues. And we collect a fairly significant amount, and there are ITINs out there.

There are sometimes refunds, but generally, because they are not eligible for most refund programs, generally what we are doing is collecting appropriate taxes from those who are working, even if they are here in an undocumented status. And we try to work with taxpayers. As I say, a significant number of those Social Security numbers are borrowed or used from relatives or someone else. But again, we do not know where they have come from or why, and our view is if we start—and we talked with INS about this, and Social Security. If we start pursuing employers and undocumented aliens, then nobody is going to file their taxes because that will be another exposure point. And the decision was made so long before I got here that it was in the government's interest for undocumented citizens to pay taxes to the extent that they want to and want to provide support for the services they receive.

Senator COATS. Well, should it not be in the government's interest also to care for the victim and put something in place that will give the victims official notification that their Social Security number has been stolen or their Tax Identification Number has been stolen and used for false purposes and, therefore, they are not sitting in front of an employer saying, there has been fraud here? Because it has an impact on individuals who have been the victims, and whether or not the IRS should pursue this, some function of government should pursue this. So can we try to set up something, some process, whereby it can be moved to the agency that can do that, if you cannot do that, or something put in place at the IRS so that it can accomplish that and address the victim's problem?

Commissioner KOSKINEN. You raise many of the facets of this problem. We would be delighted to talk with you further about it and figure out how we can deal with both aspects of it—allowing people to pay taxes so that when, sometime later on, it becomes an issue in their potential citizenship, they will have a record of having paid taxes without discouraging that, but at the same time protecting taxpayers, because protecting taxpayers is an important issue for us. So we would be delighted to talk with you further.

Senator COATS. Good. I appreciate you saying that because, if you need authority to do it, Mr. Chairman, that is something we should pursue. If the decision is made that another agency should do that or another function of government should do that, there ought to be something in place that protects the victim as well as going after the perpetrator.

Commissioner KOSKINEN. I would be delighted to talk with you further about it.

Senator COATS. Thank you. I hope we can move on that, Mr. Chairman, because one way or another, we not only have to think about prosecuting the person who stole the numbers or falsely used the numbers, but the person who has been hacked or the victim of all this needs to have some ability to clear his name and not be denied job opportunities or other opportunities because of this situation.

The CHAIRMAN. Thank you.

Senator PORTMAN?

Senator PORTMAN. Thank you, Mr. Chairman. And, Commissioner, we thank you for being here today. As you know, this is an issue of particular concern to me because it is of particular concern



to a lot of Ohioans. In fact, Senator Hatch and I were the first people to raise this issue when Ohio's 501(c)(4)s were being asked inappropriate things by the IRS. The document requests did not seem to make sense. We sent the first letter on this back in March of 2012, and, unfortunately, it continues today. There is an Ohio-based (c)(4) group called "Unite for Action" that still has not received the determination on its tax-exempt request that it first sought in 2012. So, you know, just to remind us why we are here, the IG report and our bipartisan report—I am not talking about, you know, a Republican report—all said the same thing, which is that there were words used to screen 501(c)(4) applications like "patriot," like "9/12," like "Tea Party." Seventy percent of the cases tagged for additional review—70 percent—were Tea Party cases. And to quote our report, and, again, consistent with what the IG said, "Such groups were disproportionately impacted." No question about it.

So just to remind everybody why we are here, that is the issue. And of course, there is distrust when that sort of thing happens. And of course, there should have been consequences.

So I am going to focus a little on fostering this sense of accountability you talked about in your testimony. I could not agree with you more. And real accountability comes, of course, from consequences.

I am one of those people, as you know, on this committee who believes that my constituents are suffering because of a lack of funding at the IRS. I think taxpayer service is important, and I would like to see us increase the funding for taxpayer service. But it is very difficult to have any kind of increased funding for anything at the IRS as long as there is this lack of accountability and lack of the sense that there will be consequences for actions.

So let me be specific with you. You talked about fostering a sense of accountability. You talked about the fact that we need to ensure that this happens all through the system. You answered a question today saying you sense that IRS employees now feel more comfort in being able to talk to you and go up through the command.

Let me ask you this question. For those who were involved in the mismanagement, shall we say, of the conservative group tax-exempt filings, were there any consequences? Any consequences.

Commissioner KOSKINEN. As I said, the entire chain of command, starting with the Commissioner or the then-Acting Commissioner down five levels, are all no longer with the agency.

Senator PORTMAN. They have all retired with full pensions or they have been reassigned?

Commissioner KOSKINEN. Well, I can talk to you in private. I cannot talk about individual cases.

Senator PORTMAN. Okay. Well, that is what the public information indicates. Let me give you an example. In December of last year, the Treasury Inspector General found that between 2010 and 2013—before your time, a lot of this—323 former employees were rehired by the IRS for whom records show performance and conduct issues associated with their previous employment, resulting in them leaving through formal removal or separation or termination, or leaving during an ongoing investigation.

Commissioner KOSKINEN. Those are primarily temporary and seasonal employees, and we have changed that policy to make sure that that does not happen in the future.

Senator PORTMAN. Okay. This goes to accountability. I am glad to see you have changed that policy.

As you know, under the Restructuring and Reform Act, which I was a co-author of, the IRS is allowed to terminate employees who willfully violate tax law unless the penalty is mitigated by the Commissioner. In April, the IG found that between 2004 and 2013 almost 1,600 employees had willfully violated tax law; 61 percent were handed lesser suspensions, such as reprimands or counseling; worse, a number of these employees received promotions and awards within a year of their willful noncompliance with tax law.

So again, this sense of accountability has to have consequences.

Commissioner KOSKINEN. And the response to that is, again, it reflects prior practices. We have made it clear that there will be no promotions and awards made in the year in which there is an inability to comply with the procedures and policies. So if there are disciplinary actions, there will not be promotions, there will not be awards.

Senator PORTMAN. That is good. Still, you know, 1,600 employees willfully violate, 61 percent receive lesser suspensions. So, accountability.

Commissioner KOSKINEN. And the other 40 percent actually were either suspended or dismissed. We actually dismiss a substantial number of people every year for violations of the rules, and I would be delighted to get you that detail.

Senator PORTMAN. That would be helpful.

Section 2(c) of the bipartisan report goes into some detail about the destruction of the 422 tapes that served as a backup to Lois Lerner's destroyed hard drive. You know all about this. We have talked about it today. These backup tapes were destroyed sometime in early 2014. At the time, they were the subject of a litigation hold. Your Chief Technology Officer, Terence Milholland, has actually called the destruction of these backup tapes "more significant than the loss of Lois Lerner's hard drive."

Can you tell us today how the employees who disregarded the litigation hold were held accountable for the destruction of this information relevant to the committee's investigation?

Commissioner KOSKINEN. As the Justice Department notes, there is further activity going on, and, again, I will be delighted to keep the committee advised in terms of what happens beyond that. But, again, those are two individual cases. As I say, as a general matter, both the IG in their year-long investigation and Justice found that no one purposely destroyed those tapes, the employees involved, trying to obstruct anybody's investigation. They thought of them as junk, and they did not understand the litigation or document retention program. But that has been thoroughly investigated by both the IG and the Department of Justice, and both of them found that the employees thought they were doing the right thing.

Senator PORTMAN. Again our understanding is, there have been no consequences for not honoring that litigation hold. The bipartisan report also talks about the failure of the IRS to produce responsive documents to a 2010 FOIA request. If that FOIA request

had been responded to properly, it is my belief we could have avoided a lot of this, maybe all of it. It was not responded to properly. Our bipartisan report found that these documents could have, again, kept this scandal from happening and that the search was deficient. The IRS's narrow reading was to exclude responsive documents.

Again, since our report has been released, has there been any attempt to impose consequences on those who did not properly respond to this FOIA request that could have stopped this whole thing in the first place?

Commissioner KOSKINEN. That was some time ago, and I would be happy to get you that information.

But I would note that you are exactly right. My sense of this, before I even started, was if somebody in 2012 had said, you know, we have a problem, we are trying to learn how to process all of these issues, and that had gone up the chain of command and had become public then, we would have avoided a lot of unnecessary expense.

Senator PORTMAN. Mr. Chairman, I just have two more quick questions. One, our report goes into multiple mistakes made by various employees on the be-on-the-lookout list, the so-called BOLO list. Have any mid-level managers been reprimanded for their role in these mistakes?

Commissioner KOSKINEN. Again—

Senator WYDEN. And briefly, Commissioner, because Senator Casey was passed over, and he has been waiting a long time. He was before—

Commissioner KOSKINEN. I would just note again that both the IG and the Department of Justice found that no employee behaved improperly in the sense of political bias or doing something that was out of the ordinary.

Senator PORTMAN. Again, our report, our bipartisan report, cites multiple mistakes. We understand that not only have there been no consequences, but, in fact, based on page 101 of our bipartisan report, some involved were actually promoted. So again, a culture of accountability needs to be in place for us to be able to begin this process of regaining the trust of my constituents and the American people.

Thank you, Mr. Commissioner.

The CHAIRMAN. I do apologize to Senator Casey. I was led to believe that Senator Portman was ahead of you. But we will call on you now. Please forgive us.

Senator CASEY. Mr. Chairman, thank you. I thank you and the ranking member for the hearing.

Commissioner, I want to thank you as well for your work today and your public service. You have a hard job in a difficult time.

I want to focus on the question of resources, and this happens on a pretty regular basis in this town, where folks in Congress will say the IRS or any other agency has to do X, Y, and Z, sometimes pointing the accusatory finger, but not providing the follow-up and the resources that are essential. And as you know, in mid-September, I and four other members of the Senate sent a letter to Secretary Lew talking about this issue. And I will not read the whole letter, but in a pertinent part, we talk about the con-

sequences of “shortsighted budget cuts to the IRS,” and then we give examples of the impact. The examples are taken from the Treasury Inspector General, and I am quoting here from part of the letter: “During the 2015 filing season, only 38.5 percent of callers received assistance compared to about 75 percent the year before,” and the problem is with not having the resources.

So, whether it is addressing the tax gap, whether it is improving taxpayer services, implementing data mining procedures to identify errors, whether it is combating identity theft, addressing improper payments, all of that depends upon resources. It has been my experience in State government and the Federal Government that you cannot improve a service by magic. You have to have the tools and the resources. So the focus that we were bringing in that letter was the result of getting the resources that the President has recommended for fiscal year 2016.

So can you walk through some of the impacts of those resource constraints and how they impact your ability to fulfill your responsibilities, and then, secondly, steps you are taking to prevent identity theft and improve taxpayer services?

Commissioner KOSKINEN. Well, the short answer is, it is a critical problem. I testified at my confirmation hearing 2 years ago that it was the most critical problem facing the agency, and since then the agency’s budget has been cut further.

If you look at the information, basically the thing to understand is, the OECD just put out a report—it does it every 2 years—looking at the costs of tax administration. The IRS spends almost half—or slightly more than half—of what the average of the OECD developed countries do to collect a dollar of taxes. If you look at Germany, France, England, Canada, and Australia, they spend two to three times what we spend to collect taxes. So the first point to understand is, we are already the most efficient tax agency in terms of collection of any agency of the major developed countries of the world.

Secondly, since 2010, the budget has been cut by over \$1 billion. At the same time, we have 6 or 7 million more taxpayers. We have been given “unfunded mandates,” as we call them: the Affordable Care Act, the Foreign Account Tax Compliance Act. Last year, shortly after our budget was cut, as the only major agency with a budget cut, we were asked to implement the ABLE Act and the Professional Employees Act. Since then, we have been asked to implement the Health Coverage Tax Credit Program, again, with no additional funding.

The net impact is, we get funded and we spend money on enforcement, on taxpayer service, on information technology, including cyber-protection and identity theft, and general operations and maintenance. As our budget has been cut every year over 5 years, the money has to come from somewhere. So on taxpayer service, as you know, we had an abysmal level of service last year. In terms of enforcement, the numbers show that we are losing over \$4 billion a year in collections compared to what we used to collect because we have 3,000 fewer revenue agents. Those revenue agents collect over \$1 billion a year. So actually, to save \$1 billion in funding, we are losing over \$4 billion a year in tax revenue collections.

So it is costing the government four times the amount of savings in the budget cuts.

In terms of information technology, we are dealing with cyber-criminals around the world, organized, highly sophisticated, well-funded. Our systems are attacked millions of times—not thousands, millions of times—by people trying to breach. We have been fortunate not to have a cyber-breach. We have been unfortunate that identity theft has gotten more and more sophisticated, so forget our Get Transcript unauthorized access. It was by a set of very sophisticated criminals who already had significant detailed information about taxpayers so they could masquerade more effectively as the taxpayer.

To protect against all of that, as you say, takes resources. If the budget is just flat, nothing will get better. And, in fact, at flat, we need between \$100 and \$200 million just to pay for the pay raises and inflation, and we no longer have any give. You know, no one cares more about the poor level of taxpayer service than our employees who provide that service. They believe their mission is to help people; when they answer a call, they feel good about solving a problem. They are the ones who feel as badly as the taxpayers about the fact that the lack of funding has meant that we have not had enough people to answer the calls.

Ultimately, as I have said, we do not want to go backwards and hire the 15,000 people we have lost. What we need to do is stabilize and go forward to provide better service digitally. It costs us \$43 to answer a phone call, \$52 to deal with someone when they walk into our offices, and 15 to 25 cents if we can answer the issue online digitally. And we need to move in that direction as we go.

With regard to identity theft, it is a complicated, growing problem. What we have done, the most significant step we have taken is, we brought in the CEOs, in March, of the tax preparers, the software developers, payroll providers, and the tax revenue administrators, and created a partnership. As I told them at the time, the purpose was not to tell them what to do. It was to create a partnership where the private sector, the States, and the IRS would work jointly together. We have announced—we just announced this last week—that we have implemented significant improvements across the tax system to deal with and fight identity theft this year. But going forward, again, for our systems to continue to keep up, we have to invest in them. If our budget continues to be cut, we do not have the money that we are going to need to do that, and taxpayers are going to suffer, revenues will suffer, and the agency will suffer.

Senator CASEY. Commissioner, thank you for that, and, if we are going to ask you to do a lot more, we cannot continue to give you a lot less. So we are grateful for that answer.

Mr. Chairman, thank you very much.

The CHAIRMAN. Thank you.

Senator Nelson?

Senator NELSON. Mr. Chairman, a lot of this discussion about whether or not there was intimidation could be obviated if we would just go back on the 501(c)(4)s and administer to them what the original statute said, which is civic leagues or organizations not organized for profit but operated exclusively for the promotion of

social welfare. Along in 1959 came a regulation to implement that statute, but they changed the word “exclusively” to “primarily.” So the regulation said an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the social welfare.

And so all of this flap that we are going through is unnecessary if the IRS would follow the statute that these social welfare organizations, 501(c)(4)s, would be exclusively for social welfare. But, of course, it is interpreted differently, and that is why we have the chaos that we have today in our campaign finance system where all of this—and it is now termed “dark money”—comes in to influence elections, dark because it does not have to be reported who is giving the money.

Now, the whole idea of McCain-Feingold was—and this is the campaign finance reform from about a decade ago. The whole idea was to open up the process and let the people know who is influencing elections because they would know who is giving the money. But now we see that it is nothing that a candidate for President is raising over \$100 million through 501(c)(4)s and the public does not know who is financing that, and that money is not being used, as the statute requires, for a social welfare purpose but is being used to influence an election.

We could change this whole thing, Mr. Commissioner. What do you think about all this?

Commissioner KOSKINEN. I think it is a complicated situation. We have felt that at a minimum, as I have said—and I do not know; the chairman thinks everything is clear enough as it is—but at a minimum I think we need to clarify what the standards are. One of the issues is, is “primarily” the right standard? To understand that, again, we do not think we have the ability to change the statutory framework that has been established. Our job is to try to figure out how to rationalize it and make it sensible.

Senator NELSON. Okay. And I agree with you, but the statutory framework says “exclusively” for social welfare purposes.

Now, I understand you are going through trying to figure out some kind of guidance on this. So what are you doing in issuing the guidance?

Commissioner KOSKINEN. What we are doing is looking—as I say, we have three questions that we have asked for comments on. One is, what is the definition of “political activity”? The second is, how much of it can you do? And the third part of it is, to which (c) organization should the standard apply? And how much of it you can do is the “exclusively” or “primarily” question. The definition, as I say, we think should not include nonpartisan voter registration, candidate forums, get-out-the-vote campaigns, which the previous draft did include, so that will get simplified.

And then the question of to which organization should they apply, we think you have to look at the (c)(3)s, (4)s, (5)s, (6)s, and the 527s as a group to see what—as I say, ultimately it should be up to an organization to pick which of those categories it wants to be in. We should not be driving that by our determinations.

But I would say that “primarily” is the standard used for (5)s, (6)s, and 527s, and the 527 statute was passed in the 1970s in the context of recognizing that “primarily” was already the standard.

So there are limitations on what we can do looking at only one statute. We have to look at all of the statutes in that framework.

Senator NELSON. Okay. Now, you said “primarily” was—and you listed all those statutes. But you did not say the 501(c)(4)s do not have to disclose. So what are you doing in issuing guidance with regard to that?

Commissioner KOSKINEN. What we are doing is looking at that history and looking at the fact that some of those statutory provisions by Congress were passed using “primarily” as the standard in a context in which “primarily” was the standard since, as you note, 1959. So the question is to rationalize that in light of what the congressional activity is and what the framework is. We are reviewing all the comments. We are actually taking a very close look at this. But it is not a slam-dunk to change the way the process goes. As I say, as a general matter, I do not think we are going to change the rules of the game. I know the chairman disagrees with me. But I do think it is important to clarify the rules of the game.

Senator NELSON. I do not understand what you just said.

Commissioner KOSKINEN. Maybe the better way to say it is, we are still reviewing all of this, trying to make sure that when we come up with the next draft, it is understandable, sustainable, is fair to everybody, and it is not an easy answer.

Senator NELSON. Do you agree that things have gotten out of control with regard to the interpretation of the rule “primarily used for a social purpose”?

Commissioner KOSKINEN. I think what I would agree—and our concern is—is that the facts and circumstances of how you fit into that category, what you are doing, what is primarily social welfare and what is not, so primarily political activity, should be designed and studied and assessed on facts, and the circumstances could not be less clear.

Senator NELSON. Okay.

Commissioner KOSKINEN. And so we need to clarify what is in one pocket and what is in the other.

Senator NELSON. Right. So—

Commissioner KOSKINEN. The question of how much you can do of either is a separate question, but the lack of clarity in terms of facts and circumstances, I think goes to the heart of the problem. It is what the IG said. The IG found—its last recommendation was that we should provide clarity. As I say, we should make clearer what the rules of the game are, even if we are not able to change the rules.

Senator NELSON. If you will just do this, then I think you will be doing your constitutional duty. When you look at “primarily a social purpose,” those words, and you stack that up against a commercial, paid TV advertisement that advocates for the election of a candidate or against a candidate, then you would understand that that is not primarily a social purpose. That is a political purpose. And it is there that the whole statute has been bastardized.

Commissioner KOSKINEN. And our view is that someone running one of these organizations or setting it up ought to clearly understand what is political activity, political intervention, and what is social welfare. And the facts and circumstances do not adequately

do that. And people say, "Well, it has been around a long time," facts and circumstances. But the issue of active political engagement by (c)(4)s is a relatively recent occurrence, and it has demonstrated that, in fact, greater clarity, we think, is needed. The IG agreed with that. It is why we think that everyone would be better off if, as you note, when you ran an ad, when you took an action, it would be clear which side of the line it fell on. Right now, when you do whatever you are going to do, you are subject to our interpretation and attempt to try to be fair under a facts and circumstances standard, which I don't think provides any clarity at all. It does, in fact, lead to, just as you say, the complexity of trying to figure out who is on which side of the event.

So I think the dividing line of how much you can do is important, but the definition of what you are doing is also equally important if you are going to provide clarity and be fair to everybody.

Senator NELSON. When is that clarity coming?

Commissioner KOSKINEN. Well, notwithstanding the encouragement never to show up with it, we would like to try to make sure that we could introduce the suggestion, hold the 90 days of public comment, get the public hearing held, and have that all done before the next election. So I think the chairman is right, so there is not a lot of confusion but it will be clear, because everybody has to have time to adjust, we have made it clear from the start it will not influence or be effective during the election. It would be effective next year. But I think to be effective next year, it has to actually be started sometime early this year, and, again, our goal would be to do it at a time frame outside of the active presidential campaign, certainly after next September.

Senator NELSON. So when you decide it, it would be effective for the following election cycle, not the election cycle of 2016?

Commissioner KOSKINEN. Right. And so what we are stuck with, and a thing to remember, is we are stuck right now implementing a regulation that talks about facts and circumstances. There is a misunderstanding that somehow we are not pursuing our statutory responsibilities. We are still processing applications. We do it much faster. We are trying to get them through. People do not actually have to come to us if they do not want to. But we are trying to provide standards. But to the extent that, in the ordinary course, we will be auditing organizations as to whether they are performing appropriately as a 501(c)(3), the standard we have to use is facts and circumstances. It is not that we are not in the game. We are playing according to the rules there. What we are trying to say is, as I say, we are not going to change the rules, we would just like to make them clearer.

Senator NELSON. Mr. Chairman, I would just conclude by saying that I think that the American people are going to be so fed up by the time this presidential election is over with the amount of dark money, undisclosed, unlimited money that comes into the political system, that they are going to be readily accepting of a clarifying change in the IRS statute.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, thank you. And let me just say that it is always interesting to me how our friends on the other side who have benefitted from hundreds of billions of dollars over the years



from the union movement that are never reported are finding fault with something that people have to report with regard to 501(c)(4)s. There is no use kidding. Political purposes can sometimes be social purposes, and that is why the IRS has allowed at least 50 percent to be used for political purposes, if I understand it correctly.

Senator NELSON. Mr. Chairman, I believe that all of it ought to be disclosed.

The CHAIRMAN. Well, I see you do, Senator, but then all of the union money ought to be disclosed too, and—

Senator NELSON. I agree.

The CHAIRMAN [continuing]. It amounts to hundreds of millions of dollars.

Senator NELSON. I agree.

The CHAIRMAN. Well, it is never going to be, because the Democrats are not going to allow that to happen. And all I can say is, these groups have to disclose to the IRS what they are doing, and the IRS can make some determinations as to whether they are doing it properly or not.

Senator NELSON. See, it is this kind—if the chairman would, respectfully this Senator asks that you would yield for me just to make a comment. It is this kind of back-and-forth that the American people are so sick and tired of, and then all this money comes in from whatever source. I would agree with you. Disclosure ought to be across the board.

The CHAIRMAN. Yes, but that is not going to happen. You know it and I know it. And he cannot just make laws at the IRS.

Secondly, it is so one-sided in favor of Democrats that I really do not understand what the argument is all about. All I can say—

Senator NELSON. Mr. Chairman—

The CHAIRMAN. All I can say is, it would be wonderful if everybody could disclose what they are doing and what it is for. That is not going to happen. We do not have, on either side, enough political fortitude to be able to resolve those problems.

Senator NELSON. Mr. Chairman?

The CHAIRMAN. All I can say is, you are asking Mr. Koskinen to unilaterally, on his own accord, straighten out how “social purposes” should be interpreted when they are already interpreted the way they are.

Senator NELSON. Mr. Chairman, I would just humbly say that the system is not in order. It is in chaos. In my last reelection, having to go around and comply with the laws, that I am limited to personal money, and all of it, every dime of it, has to be disclosed, and then having the disadvantage in my last reelection, which was 3 years ago, the disadvantage that all of this avalanche of unlimited and undisclosed “where is it coming from?” money comes in against me to try to defeat me, that is not a fair system.

The CHAIRMAN. It may not be, Senator, but all I can say is that the laws have been interpreted this way, and I have to say that many on your side will never agree that the unions should have—and I am not saying many. A universally large percentage on your side would say that the unions do not—

Senator NELSON. Well, let us—

The CHAIRMAN. You and I might agree, because you say that they ought to disclose too. Well, they do disclose hard money. It is the soft money that they do not disclose.

Now, at least these 501(c)(4)s have to disclose hard money, and, you know, there is a reason why they do not require people, whether it is on the Democrat side or the Republican side, to necessarily disclose who runs these organizations, because we know that there will be people who will deliberately go after the people who donate—

Senator NELSON. Would the chairman yield for a question?

The CHAIRMAN [continuing]. And do it in a very unfair way, and so this is something that is not as easy to discuss as I think you are making it.

Senator NELSON. Would the distinguished chairman yield for a question?

The CHAIRMAN. Sure.

Senator NELSON. And he knows that I believe that he is distinguished and a fair-minded individual.

The CHAIRMAN. Well, likewise.

Senator NELSON. Thank you. Well, the present system is out of kilter. It is, in effect, no campaign finance law, the way you can do things now.

Now, would you not think that we needed some kind of order in the system?

The CHAIRMAN. Well, we do have an order in the system. I do not like the system myself, but the fact of the matter is that we—I think one reason why the Supreme Court ruled the way it did is because one side had a decided advantage of soft money that the other side did not have, meaning the Republicans did not have.

Now, whether that is right or wrong, neither side should have an advantage over the other, and, unfortunately, that continues today.

Senator NELSON. Well, the chairman will have the last word in this hearing, but I think that the chairman and I can at least agree that the present system, the American people are getting fed up with it. And we had better start to find a more equitable way to finance our elections.

The CHAIRMAN. Well, I think everybody would probably agree with that generalization. I do not think there is any question about that.

On the other hand, it is hard for me to see why Democrats can complain when they have been benefitting from a whole raft of money that is never reported and is used consistently against Republicans throughout the country. I know. I have been a target of some of this money. And it is not just some. It is big-time dollars. And I suspect that is one reason why the Supreme Court made the ruling that it did to try to even things up. But even 501(c)(4) groups, they have to disclose how they use their money, and they have certain obligations that exist in law today.

Look, we are not going to solve that here. All I can say is, the system is not fair—the Republicans think it is disastrously not fair. Democrats are thinking, now that you have 501(c)(4) organizations that can spend money on politics without disclosing the names of their people that—well, let us just go back to one of the original cases, the NAACP. Where does it get its money? And Democrat ar-

guments were, you should not have to disclose who puts the money up for politics in the NAACP because it could be used to discriminate against the people who put the money up.

You know, these are not simple issues, but all I can say is that I do not see how Democrats can complain when they have had a decided advantage all these years through the unions and other organizations that really do not ever have to report what they are really doing at all.

Senator NELSON. Well, Mr. Chairman, this Democrat is complaining, and the reason I am complaining is, I am sure that the fair-minded chairman of this committee does not believe that one wrong should be corrected with another wrong.

The CHAIRMAN. I am with you. I am with you on that. All I am pointing out is that your side will never give up the decided advantage it has. It is just that simple. And if you could do that, we could do business. We could really do business, and we could solve these problems overnight. But you will never be able to get them to fully disclose all the soft money they get from unions and so many other groups that I could name.

Let me just say that we have appreciated your patience here today, Mr. Koskinen. I do not think anybody can whitewash what happened. I am glad you are making changes that hopefully will ensure that some of this bias will never happen again. And I do not see how anybody can say that, you know, these are just mistakes. If you look at what Lois Lerner did and a raft of others who were with her, it was a lot more than just mistakes. It was wrong, and it was deliberately wrong. And I do not care how much you try to whitewash it. You cannot do that.

But to make a long story short, I am very appreciative that you are at least trying to right these wrongs and trying to do what you should do. I have a high opinion of you, and I will get in trouble with the House by saying this, but I have a high opinion of you and basically think that you are trying to put things in order. And I am going to count on your doing that.

Thank you so much for your patience throughout this hearing.

Commissioner KOSKINEN. Thank you, Mr. Chairman.

The CHAIRMAN. With that, we will—and let me just say this. Let me just thank everyone who attended and participated in today's hearing. I thought this was a thoughtful and useful discussion today that will hopefully help us in our future efforts to improve the functioning of the IRS. I want to thank you again, Mr. Koskinen, for agreeing to be here and for your agency's response and cooperation with regard to the committee's report and recommendations.

As always, any member of the committee should feel free to submit written questions for the record. I am going to set the deadline for written questions at 2 weeks from today. That would be Tuesday, November 10th, and with that, this hearing is now adjourned. Thanks so much.

Commissioner KOSKINEN. Thank you.

[Whereupon, at 11:10 p.m., the hearing was concluded.]



## APPENDIX

### ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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PREPARED STATEMENT OF HON. ORRIN G. HATCH,  
A U.S. SENATOR FROM UTAH

WASHINGTON—Senate Finance Committee Chairman Orrin Hatch (R-Utah) today delivered the following opening statement at a Committee hearing to examine the Internal Revenue Service's (IRS) response to the Committee's bipartisan report that detailed their investigation into the IRS's treatment of organizations applying for tax-exempt status.

In May 2013, the Treasury Inspector General for Tax Administration revealed that, in the run-up to the 2010 and 2012 elections, the Internal Revenue Service had targeted certain organizations applying for tax-exempt status for extra and undue scrutiny based on the groups' names and political views.

Needless to say, we took this matter very seriously. Indeed, at the time, both Republicans and Democrats condemned the agency's actions. And, as the Senate committee with exclusive legislative and oversight jurisdiction over the IRS, the Finance Committee launched a bipartisan investigation into the matter.

In fact, our investigation was the most thorough and the only bipartisan investigation conducted with regard to these events.

On August 5th of this year, after more than 2 years of investigation, we released a 375-page bipartisan investigative committee report that included approximately 4,500 pages of exhibits. This report is, I believe, the definitive record of what occurred at the IRS and why.

As we all know, last week, the Department of Justice stated publicly that they would not be pressing criminal charges with regard to these events at the IRS. This has led some to argue that the Justice Department is corrupt or biased in some way. Others have said that this decision proves that nothing scandalous occurred at the IRS.

I believe the committee's report speaks for itself on this matter. And, in my opinion, rather than fueling the echo chamber, we would do better to focus on what we know actually happened and what changes need to take place to make sure it doesn't happen again.

That's why we are here today.

The committee's report included 10 major findings that formed the basis of various recommendations for changes that we believe the agency should make to ensure the IRS's actions remain above board.

The purpose of today's hearing is to hear directly from the IRS about their response to our report and their progress in adopting our recommendations. Toward that end, I want to thank Commissioner Koskinen for being here today and for the agency's thoughtful response to our recommendations.

In that response, the IRS indicated that they have implemented all of the bipartisan recommendations from the report that are within the agency's control, as well as the separate Majority and Minority recommendations.

Our overall goal here should be to restore the credibility of the IRS and ensure that this very powerful agency treats all American taxpayers fairly.

While I want to commend the IRS for the efforts they have made thus far, it my understanding that, up to now, most of the changes they've made have been procedural in nature and very little has been done to begin work on the needed structural changes at the agency. Today, I hope to hear more details as to why these types of changes are being delayed.

At the same time, I believe the Finance Committee should be considering statutory changes that will improve upon the status quo. For example, there was bipartisan agreement in the report on the need to update the Hatch Act to ensure that, with regard to political activities, IRS employees receive the same considerations as employees of other highly-sensitive agencies, like the Federal Election Commission and the Federal Bureau of Investigation.

In addition, as the Majority Views in the report noted, and as I have stated publicly on multiple occasions, I have serious concerns about the influence of labor union activity at the IRS. While I am not anti-union and while I do not oppose collective bargaining in general, we know that two-thirds of IRS workers are represented by a union organization that is very politically active and that a fair number of IRS employees work full-time for the benefit of that union. I don't think it's much of a stretch to argue that such a strong union presence could have contributed to a politicized environment at the IRS.

While current law allows Federal Government employees to be represented by unions, Congress has made a number of exceptions to this policy, generally with agencies that have important law enforcement obligations or perform other highly sensitive work. And, while I expect there to be some resistance to this idea, I think it is only reasonable that we take the time to consider whether the IRS should be placed in a similar category.

I hope that today we can have a good discussion and get Commissioner Koskinen's views on these and other legislative proposals.

Ultimately, the theme that I want to stress most today is accountability.

Our report clearly shows that political targeting at the IRS resulted from a number of bad decisions made by a number of different officials. However, as of yet, very few of these individuals have been held accountable, while others have since received bonuses and even promotions. While I am concerned about this apparent lack of individual accountability, I am more concerned that the IRS lacks the necessary structural and procedural mechanisms to ensure that, as an agency, it remains accountable.

The recommendations we included in our report were designed to provide this type of accountability and I look forward to discussing our ideas in more detail today.

Before I conclude, I just want to briefly comment on the ongoing effort at the IRS to enact new regulations regarding the political activities of 501(c)(4) organizations. Obviously, this is an issue that deeply concerns a number of people throughout the country, including members of this committee.

As we know, regulations proposed in 2013 were criticized by people and organizations across the political spectrum, and were subsequently withdrawn. That poorly drafted proposal would have created nonsensical rules and constitutionally dubious speech restrictions. Oddly enough, it would have created stricter standards for 501(c)(4) organizations than exist for public charities, which would be a perverse reversal of roles for these types of organizations.

While this issue is not directly related to the committee's report on the IRS's political targeting, I think it's fair to say that agency still carries with it a cloud of perceived political bias. Therefore, I would caution Commissioner Koskinen and others in the administration that have made this regulation a priority to focus instead on actions to restore the IRS's credibility and to abandon any effort to inject more rules and restrictions into the political process.

I expect that members of the committee will want to discuss this matter today as well as, once again, it is an issue that is on the minds of many people.

PREPARED STATEMENT OF HON. JOHN A. KOSKINEN, COMMISSIONER,  
INTERNAL REVENUE SERVICE

## 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 e-mails 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 6 of the recommendations in the separate sections prepared by the Major-

ity 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 3 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, DC 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 2 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 ap-

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 e-mails 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 e-mails 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 e-mail 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 e-mail 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 e-mail 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 28th 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 “correctable 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.

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**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 2 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 sec-

tion 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.<sup>1</sup> 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 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 non-exempt 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 non-partisan 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

<sup>1</sup>S. Rept. No. 93–1357, 93d Cong., 2d Sess. (December 16, 1974), at 29.

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 time frames 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 e-mails 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 exam-



ple, 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.

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**DEPARTMENT OF THE TREASURY**  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

September 10, 2015

The Honorable Orrin G. Hatch  
The Honorable Ron Wyden  
Committee on Finance  
U.S. 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 fur-

ther 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 e-mail 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 e-mail 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

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## 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)

September 10, 2015

### 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.<sup>1</sup>

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.<sup>2</sup> 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)
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**<sup>3</sup>

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

<sup>1</sup>The IRS also plans to address several implicit findings and recommendations contained in the Finance Committee Report.

<sup>2</sup>"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).

<sup>3</sup>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.

facilitating public access to relevant materials through substantive updates to the Internal Revenue Manual (IRM) sections<sup>4</sup> and revenue procedures<sup>5</sup> that relate to the application process. These resources continue to be available to the public via the IRS website.<sup>6</sup> The EO function has also made new tools available to exempt organizations, including the online, interactive Form 1023i.<sup>7</sup> 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.

### **Streamlining the Exempt Organizations Determination Process to Ensure Timely Processing and Reduce Delay**<sup>8</sup>

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"<sup>9</sup> and introduced Form 1023-EZ to simplify the process for smaller applicants.<sup>10</sup> 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.<sup>11, 12</sup>

The EO function also focused on revising procedures for technical assistance requests, which must be completed within established timeframes.<sup>13</sup> In 2013, for example, the EO function initiated a new procedure pursuant to which specialists have 60 days to complete responsive 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.<sup>14</sup>

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

<sup>4</sup>IRM 7.1.2, 7.20.1, 7.20.2, 7.20.3, 7.20.6.

<sup>5</sup>Rev. Proc. 2015-4, 2015-5, 2015-8, 2015-9, 2015-10, and 2014-11.

<sup>6</sup>[www.irs.gov/Charities-&-Non-Profits/Applying-for-Tax-Exempt-Status](http://www.irs.gov/Charities-&-Non-Profits/Applying-for-Tax-Exempt-Status).

<sup>7</sup>[www.irs.gov/Charities-&-Non-Profits/Applying-for-Tax-Exempt-Status](http://www.irs.gov/Charities-&-Non-Profits/Applying-for-Tax-Exempt-Status).

<sup>8</sup>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, and B2.3; Finding B3, Recommendation B3.2. It also relates to Majority Recommendation #4, p. 267. See Appendix A, Recommendation Maj4.

<sup>9</sup>Interim Guidance Memorandum, TE/GE-07-0315-0006 (March 12, 2015).

<sup>10</sup>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>.

<sup>11</sup>"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.

<sup>12</sup>This discussion relates to Minority Recommendation #3, p. 314. See Appendix A, Recommendation Min12.

<sup>13</sup>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).

<sup>14</sup>"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.

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.<sup>15</sup> The EO function will continue working toward further reducing or eliminating the remaining over-age inventory.

#### **Realigning Organizational Functions for Improved Service**<sup>16</sup>

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.<sup>17</sup> For instance, the EO Director and the EO Director of Rulings and 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 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**<sup>18</sup>

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 Com-

<sup>15</sup> 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.

<sup>16</sup> This discussion relates to bipartisan Finding #5 and the related bipartisan Recommendation. See Appendix A, Finding B5, Recommendation B5.1.

<sup>17</sup> See Appendix B, “Before and After Structures of the EO Division.”

<sup>18</sup> 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, and B2.3; Finding B3, Recommendation B3.1.

missioner is informed of the number of over-age cases through regular updates provided every 6 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.

#### **Strengthening Risk Management Through Improved Communication**<sup>19</sup>

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.<sup>20</sup>

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**<sup>21</sup>

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.

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

<sup>19</sup>This discussion relates to bipartisan Finding #4 and the related bipartisan Recommendation. See Appendix A, Finding B4, Recommendation B4.1.

<sup>20</sup>IRM 1.54.1, "TE/GE Roles and Responsibilities."

<sup>21</sup>This discussion relates to bipartisan Finding #6 and the related bipartisan Recommendation. See Appendix A, Finding B6, Recommendations B6.1.

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<sup>22</sup>**

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.<sup>23</sup> 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.<sup>24</sup> 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,<sup>25</sup> 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.<sup>26</sup> Following the recommenda-

<sup>22</sup>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 and B7, Recommendations B2.1, and B7.1.

<sup>23</sup>Interim Guidance Memorandum, TE/GE-07-1014-0027 (October 24, 2014).

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

<sup>25</sup>[www.irs.gov/Charities-%26-Non-Profits/Charitable-Organizations/Exempt-Organization-Sample-Questions](http://www.irs.gov/Charities-%26-Non-Profits/Charitable-Organizations/Exempt-Organization-Sample-Questions).

<sup>26</sup>See the Finance Committee Report at pp. 128-29.



tions contained in the July 2015 GAO Audit report,<sup>27</sup> the EO function issued revised procedures for the composition and operation of the Political Activity Referral Committee.<sup>28</sup> 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 2 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.

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.<sup>29</sup> 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.<sup>30</sup> 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<sup>31</sup>**

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 and 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.<sup>32</sup> The Disclosure Office and the business unit contacts maintain open lines of communication, and follow-up with FOIA requestors to better define the scope of their requests whenever there are questions.<sup>33</sup> 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 initiated in an effort to provide the requester with access to as many responsive

<sup>27</sup> “IRS Examination Selection Internal Controls for Exempt Organization Selection Should Be Strengthened” (GAO-15-514) (July 2015).

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

<sup>29</sup> This discussion relates to Majority Recommendation #5, p. 267, as well as Minority Recommendation #2, p. 314. See Appendix A, Recommendations Maj5 and Min11.

<sup>30</sup> 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.

<sup>31</sup> This discussion relates to bipartisan Findings #8 and #9, and the related bipartisan Recommendations. See Appendix A, Findings B8 and B9, Recommendations B8.1, B9.1, and B9.2.

<sup>32</sup> 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).

<sup>33</sup> IRM 11.3.13.6.2 and 11.3.13.6.3(13); (08-14-2013).

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.<sup>34</sup> 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.<sup>35</sup> Additionally, TIGTA conducts periodic reviews of the IRS's compliance with FOIA. In some instances, TIGTA has noted incidences of improper disclosures.<sup>36</sup> 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**<sup>37</sup>

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 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.<sup>38</sup> The IRS plans to improve this guidance by adding more specific instructions and clarifying examples.

#### **Responding to Government Accountability Office Recommendations**<sup>39</sup>

The GAO's July 2015 report made 10 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

<sup>34</sup> IRM 11.3.13.8(3) and (9); (08-14-2013).

<sup>35</sup> IRM 11.3.13.6.3 (8-14-2013).

<sup>36</sup> TIGTA report 2014-30-064 (9-17-2014); See

<https://www.treasury.gov/tigta/auditreports/2014reports/201430064fr.pdf>.

<sup>37</sup> This discussion relates to bipartisan Finding #10 and the related bipartisan Recommendation. See Appendix A, Finding B10, Recommendations B10.1.

<sup>38</sup> 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 e-mails is that all e-mails that relate to agency business should be printed and kept with the file, and that work-related e-mails are subject to FOIA and discovery. IRM 1.10.3.2.4; IRM 1.10.3.3.5 (03-06-2015).

<sup>39</sup> This discussion relates to bipartisan Finding #7, and the related bipartisan Recommendation #2. See Appendix A, Finding B7, Recommendation B7.2.

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<sup>40</sup> 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 10 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.<sup>41</sup> 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 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.<sup>42</sup> 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,<sup>43</sup> amending section 7428 to provide for declaratory judgment actions by applicants for tax-exempt status under section 501(c)(4), (5), and (6),<sup>44</sup> and amending several other Internal Revenue Code provisions relating to exempt organizations.<sup>45</sup>

In addition, the Committee recommended that TIGTA conduct a review of the revised EO Examination procedures, no later than July 1, 2017.<sup>46</sup> 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 Treas-

<sup>40</sup> TE/GE-04-0715-0018 (July 16, 2015).

<sup>41</sup> This discussion relates to bipartisan Finding #1 and the related bipartisan Recommendation #3. See Appendix A, Finding B1, Recommendation B1.3.

<sup>42</sup> This discussion relates to bipartisan Finding #1 and the related bipartisan Recommendation #2. See Appendix A, Finding B1, Recommendation B1.2.

<sup>43</sup> This discussion relates to Majority Recommendation #2, p. 267. See Appendix A, Recommendation Maj2.

<sup>44</sup> This discussion relates to Majority Recommendation #3, p. 267. See Appendix A, Recommendation Maj3.

<sup>45</sup> This discussion relates to Majority Recommendation, p. 258. See Appendix A, Recommendation Maj6.

<sup>46</sup> This discussion relates to bipartisan Finding #7 and the related bipartisan Recommendation #3. See Appendix A, Finding B7, Recommendation B7.3.

ury and establishing it as an independent, stand-alone agency.<sup>47</sup> 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.

### **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.

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<sup>47</sup>This discussion relates to Majority Recommendation #1, p. 267. See Appendix A, Recommendation MAJ1.

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 #)
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 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.	8	Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11)
		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 manner.	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) Fostering a Culture of Accountability (5) Ensuring Neutral Review Processes (8)

Appendix A—Finance Committee Findings and Recommendations—Continued  
 I. Bipartisan (B) Findings and Recommendations

Finding	Description	Recommendation	Description	Finance Committee Report Page #	IRS Report Subheading (Page #)
		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) 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) Fostering a Culture of Accountability (5)
B3	The IRS took as long as 5 years to come to a decision on applications for tax-exempt status submitted by Tea Party 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.	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 subordinates fail to follow these standards.	9	Fostering a Culture of Accountability (5)
		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)

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 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.	B6.1		Set minimum training standards for all managers within the EO division to ensure that they have adequate technical ability to perform their jobs.	10	Bolstering Employee Training (6)
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 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.	B7.1		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)

**Appendix A—Finance Committee Findings and Recommendations—Continued**  
**I. Bipartisan (B) Findings and Recommendations**

Finding	Description	Recommendation	Description	Finance Committee Report Page #	IRS Report Subheading (Page #)
		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 disclosed sensitive taxpayer information when responding to Freedom of Information Act (FOIA) requests. Employees who were responsible for these disclosures received minimal or no discipline.	B8.1	Require all outgoing FOIA responses to be reviewed by a second employee to ensure that taxpayer information is not improperly disclosed.	11	Improving FOIA Procedures (9)
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)



B10	<p>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 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."</p>	BS.2	<p>To be consistent with the intent of 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.</p>	11	Improving FOIA Procedures (9)
	B10.1		<p>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.</p>	11	Review the Use of the Office Communicator System (10)
2. Majority (Maj) Recommendations					
	Maj1		<p>The IRS must be removed from the authority of the Treasury Department and established as an independent stand-alone agency.</p>	267	Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11)
	Maj2		<p>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.</p>	267	Recommendations outside IRS Jurisdiction or that Require Legislative Changes (11)

Appendix A—Finance Committee Findings and Recommendations—Continued

1. Bipartisan (B) Findings and Recommendations

Finding	Description	Recommendation	Description	Finance Committee Report Page #	IRS Report Subheading (Page #)
2. Majority (Maj) Recommendations					
		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)
		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

	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)
	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)

Appendix A—Finance Committee Findings and Recommendations—Continued

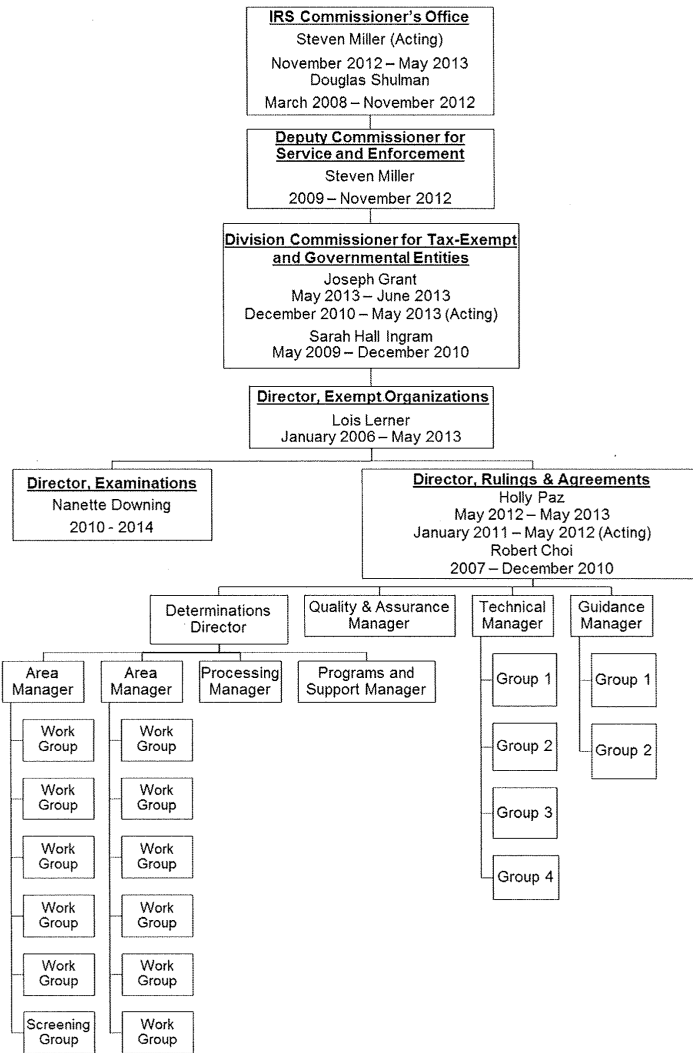
1. Bipartisan (B) Findings and Recommendations

Finding	Description	Recommendation	Description	Finance Committee Report Page #	IRS Report Subheading (Page #)
	2. Majority (Maj) Recommendations				
		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)
		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)

	Min11	<p>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.</p>	314	Ensuring Neutral Review Processes (8)
	Min12	<p>The Democratic staff recommends that additional work be done to determine what reforms to 501(c)(5) and 501(c)(6) organizations are needed.</p>	314	Streamlining the EO Determination Process to Ensure Timely Processing and Reduce Delay (3)

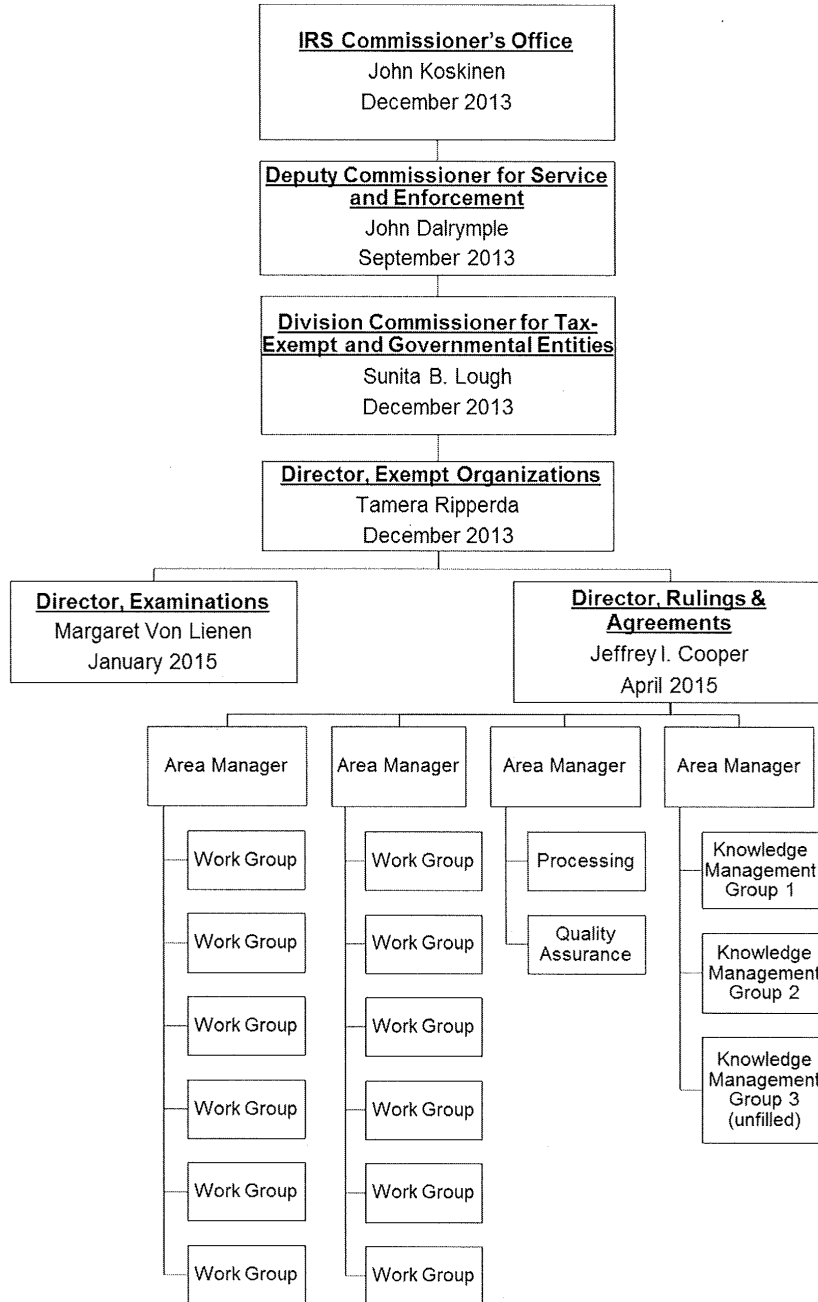
**Appendix B – Comparison of Organization Charts for TE/GE's Exempt Organizations<sup>48</sup>**

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



<sup>48</sup> Note: these charts represent the Exempt Organizations - Rulings and Agreements group, which is one segment within the IRS's Tax-Exempt and Governmental 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)**

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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 and 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 2 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 2 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](http://www.irs.gov)



Control No: TEGE-04-0715-0018

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					

QUESTIONS SUBMITTED FOR THE RECORD TO HON. JOHN A. KOSKINEN

QUESTIONS SUBMITTED BY HON. RON WYDEN

*Question.* On October 26, 2015, the press reported that the IRS obtained and received training for a cell-site simulator, commonly referred to as a stingray, which works by mimicking a cell phone tower in order to collect data from phones that connect to it. This comes on the heels of other news reports that many companies have taken to tracking their employees' movements through cell phone trackers in order to avoid triggering a taxable presence in foreign countries. The IRS has an important role to play in combating money laundering, drug trafficking, and international tax dodging, but tax enforcement and protection of personal privacy must not be mutually exclusive. Please provide the following information about IRS use of cell-site simulators:

How many times over the past 5 years did IRS criminal investigators use a cell-site simulator or IMSI-catcher to extract information from a mobile phone during the course of an investigation?

Answer. In the last five (5) years, IRS Criminal Investigation (IRS-CI) has used cell-site simulator technology (also known as Stingray) to track the location of forty-six (46) known cellular devices. As discussed below, the only information captured by the device was signaling data. The cell-site simulator device purchased is not capable of extracting data such as email, call logs, text messages, or photos that are stored on the target cellular device.

The cell-site simulator was first deployed in April 2012 and has been used in support of eleven (11) Federal grand jury investigations led by the appropriate United States Attorney's Office, which provided oversight and guidance in obtaining the proper court orders and/or tracking warrants. These eleven (11) investigations involved Stolen Identity Refund Fraud (SIRF) and money laundering violations. Thirty-eight (38) cellular devices were tracked as part of these investigations.

IRS-CI has also used the cell-site simulator to assist other federal and local law enforcement agencies in four (4) non IRS-CI investigations. Three (3) of the four (4) cases were non-grand jury State investigations. In each instance where IRS-CI provided assistance, IRS-CI Special Agents operated the cell-site simulator, ensured the proper State court orders had been obtained and followed all applicable laws under the guidance of a State Prosecutor. The three (3) cases involved attempted murder, murder and gun trafficking investigations. These investigations tracked seven (7) cellular devices. One (1) of the four (4) cases was a DEA federal grand jury narcotics investigation. In this instance, IRS-CI operated the cell-site simulator in coordination with its taskforce partner DEA. IRS-CI verified that DEA obtained the appropriate federal court order and followed all applicable laws under the guidance of an Assistant U.S. Attorney (AUSA). This joint taskforce case was a narcotics investigation and tracked one (1) cellular device.

*Question.* During investigations, what is the precise goal of the use of such a device? What types of information have been collected?

Answer. As the law enforcement arm of the IRS, IRS-CI's goal of using cell-site simulation technology is to identify and locate individuals under investigation for potential criminal violations within IRS-CI's investigative jurisdiction to include tax-related identity theft and money laundering. As identified, prior to November 30, 2015, IRS-CI used the cell-site simulator to assist other federal and local law enforcement agencies in four (4) non-IRS-CI investigations. Subsequent to November 30, 2015, with the implementation of IRS-CI's Cell-Site Simulator Policy, IRS-CI will no longer deploy the cell-site simulator in non-IRS-CI investigations.

Cell-site simulators used by IRS-CI provided only the relative signal strength and general direction of the subject cellular device; they do not function as a GPS locator, as they do not obtain or download any location information from the device or its applications. When in operation mode, the cell-site simulator received unique identifying numbers from multiple devices in the vicinity of the simulator. Once the cell-site simulator identified the specific cellular device it was looking for, it only obtained the signaling information related to that particular known device. The cell-site simulator did not remotely capture voice communication, emails, texts, contact lists, images or any other content data from the devices. Moreover, cell-site simulators used by IRS-CI did not provide subscriber account information (for example, an account holder's name, address or telephone number).

Any collected signaling data was deleted at the end of each daily operation.

*Question.* During the Committee's October 27, 2015 hearing, Commissioner Koskinen stated IRS cell-site simulators "can only be used with a court order. It can only be used based on probable cause of criminal activity." What type of court order do IRS investigators obtain before using cell-site simulators? Please note the number of times each type of court order was obtained over the past 5 years.

Answer. IRS-CI Special Agents obtained the following court orders through the United States Attorney's office in seeking approval to utilize the cell-site simulator in criminal investigations. Other than the three State cases and one DEA case noted, **all criminal cases utilizing the cell site simulator were Grand Jury cases within IRS-CI's investigative jurisdiction.**

- Search Warrants—24
- Pen Register/Trap Trace Court Order—14
- Warrant and Order for Cell phone Location Information and Pen Register—

IRS-CI deployed the cell-site simulator consistent with Department of Justice (DOJ) Policy which, prior to September 3, 2015 permitted use when authorized through a court order pursuant to the Pen Register Statute. Department of Justice updated the policy effective September 3, 2015 to permit deployment of the device after obtaining a search warrant supported by probable cause and issued pursuant to Rule 41 of the Federal Rules of Criminal Procedure, subject to certain exceptions. IRS-CI continued to follow DOJ's updated policy and then issued a policy that mirrored the DOJ policy on November 30, 2015.

IRS-CI has also used the cell-site simulator to assist local law enforcement agencies in three (3) non-IRS-CI State investigations. In each instance, IRS-CI operated the cell-site simulator, ensured the proper State court orders had been obtained and followed all applicable laws under the guidance of a State Prosecutor.

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QUESTIONS SUBMITTED BY HON. MICHAEL B. ENZI

*Question.* The Senate Finance Committee's bipartisan report found that the workplace culture in the Exempt Organizations Division placed little emphasis on valuing or providing customer service. Is this type of culture more pervasive within the IRS than just the EO Division? How do we know that it is not? What is the IRS doing to make sure this type of work culture is not wide-spread, now or in the future?

*Answer.* Since I became IRS Commissioner 2½ years ago, I have held town halls at IRS offices across the country, in person and virtually, giving me the opportunity to talk with and listen to over 20,000 employees at all levels of the organization. From their questions, concerns and suggestions I have learned of their concern about the lack of resources that prevent them from providing the level of taxpayer service that they think taxpayers deserve.

When you hear employees talk about the personal satisfaction they derive from being able to answer a taxpayer's question or point them in the right direction, you begin to understand the great emphasis IRS employees place on valuing and providing top-quality customer service to taxpayers. Indeed, providing taxpayers with quality service is one of the taxpayer rights embodied in the Taxpayer Bill of Rights (TBOR) that the IRS adopted in 2014. The TBOR is an important document that outlines the 10 fundamental rights taxpayers have when working with the IRS.

As a regular matter, the IRS provides year-round assistance to taxpayers to help them fulfill their tax obligations. The taxpayer assistance provided by the IRS comes in many forms, including: outreach and education programs; issuance of tax forms and publications, rulings and regulations; toll-free call centers; in-person help at Taxpayer Assistance Centers (TAC); and our website, *IRS.gov*. The budget cuts that resulted in our reduced levels of service are particularly challenging for our employees who take pride in meeting our customers' needs, and even with the most energetic response by our employees, the IRS's constrained resources are such that we were not able to provide our customers with the service that they need and deserve. The additional funding that Congress provided the IRS for FY 2016 to improve service to taxpayers was a very helpful development for taxpayers and has enabled the IRS to provide our customers with more of the quality service they need to meet their tax needs.

The IRS's commitment to taxpayer service also means assisting taxpayers who are facing difficult economic times and other hardships in meeting their tax obligations; and to that end, we have a variety of installment payment options to help taxpayers who need an alternative payment schedule.

I have personally seen and heard about many instances where IRS employees have provided high quality service and thus, made a difference for taxpayers. Some excerpts from some recent letters from taxpayers: "She was the consummate professional, and I felt her kindness and human decency;" "I feel she went out of her way to help me," and; "when we complimented her service, she replied, 'I love my job.'" Similar comments have been received from taxpayers about our telephone assistants, employees at our Taxpayer Assistance Centers and enforcement personnel.

As your question relates specifically to customer service in our Exempt Organizations (EO) Division, we would like to note that EO's commitment to providing taxpayers with timely service was the underpinning for the IRS's streamlining of the EO determination process that led to the creation of the Form 1023-EZ. In EO and across the IRS, our employees and our workplace culture is committed to delivering

on the IRS mission, which is to “provide America’s taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.”

*Question.* Regarding standards for customer service, the GAO continues to recommend that the IRS benchmark its telephone service measures to the best in business to help identify ways to improve service and maintain a high quality service. According to the GAO, even though the IRS has in the past benchmarked its telephone level of service measures to both private and public sector organizations, the IRS has disagreed with the GAO’s recommendation to continue. The GAO over a year ago said: “While reduced funding has resulted in fewer resources available to IRS, a better understanding of the nature and size of service gaps could help it provide the best service possible with declining resources.” Why has the IRS declined to make this type of effort now—that is, benchmarking its telephone level of service measures to other organizations?

*Answer.* The IRS has recently decided to, as GAO suggests, update our benchmarking comparisons against public and private sector organizations with comparable customer service goals and challenges. The agencies participating in the benchmark study were open to periodic benchmark reviews; however at this time a set schedule has not yet been established. The IRS continues to note that private sector organizations often do not face the same budgetary constraints, budget volatility and legislative challenges that federal agencies face. Nor do many private sector organizations face an intense filing season, with condensed accelerated demands for a portion of the year, and a customer base largely interacting with us once a year rather than transacting with us throughout the year. Therefore, defining appropriate service levels against private industry or customer expectations is challenging given the wide variation in private industry business models.

*Question.* Of concern is the fact that the IRS has sent Consumer Financial Protection Bureau flyers to taxpayers with their tax refund checks. The flyers solicit information from the recipient taxpayers.

The Consumer Financial Protection Bureau has the power to examine and to impose reporting requirements on financial institutions, enforce certain consumer protection laws and regulations and make certain rules and regulations. I do not believe this authority extends to soliciting Americans’ stories about money. Additionally, since the Consumer Financial Protection Bureau is funded by a transfer of non-appropriated funds from the Federal Reserve System’s combined earnings, I question whether it is appropriate to use taxpayer dollars to advertise the Consumer Financial Protection Bureau, as the IRS did by including this mailing with tax refunds. Lastly, because the Consumer Financial Protection Bureau is supposed to be an independent organization, I do not believe the Treasury Department should be soliciting information on behalf of the entity.

I would appreciate answers to the following questions:

- What authority did the Treasury Department rely on to include this Consumer Financial Protection Bureau information with IRS tax refunds?
- What agency paid to print and mail the Consumer Financial Protection Bureau flyers?
- Has the IRS respected all the boundaries and complied with all laws concerning confidential taxpayer information with the inclusion of the Consumer Financial Protection Bureau flyer and solicitation of information from taxpayer recipients?

*Answer.* The IRS does not mail refund checks to taxpayers. This process is handled by the Bureau of Fiscal Service (BFS) at the Department of Treasury and they make the decision about what, if anything, will be included with the refund check. In consultation with the BFS, we have determined the following.

Treasury’s authority to make payments on behalf of the United States Government, and to issue checks and other drafts, is found in the United States Code at, inter alia, 31 U.S.C. §§ 321, 3321, and 3325. In 2013, Treasury successfully leveraged check inserts to help federal beneficiaries meet Treasury’s electronic payment requirement. Check inserts also have been used for other purposes such as Social Security Administration Cost of Living Adjustment notifications or Medicare payment information. Many check inserts include information that directs the check recipient to a government website or a phone number for important program information. Check insert messages may simply concern public interest matters such as disaster preparedness or fraud and identity theft prevention.

At the request of the CFPB, the BFS included check inserts in approximately 11.9 million tax refund mailings from February to April of this year. The CFPB was responsible for all printing and shipping costs related to these check inserts. The CFPB was also responsible for reimbursing the BFS for the cost of its receiving and enclosing these inserts (IAA for \$19,397 in FY 2016). No BFS appropriations were used as a result of the CFPB check enclosures.

The BFS is not in possession of any taxpayer recipient information as a result of actions taken by the taxpayer in response to the CFPB flyer. The BFS neither collects nor receives such information.

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PREPARED STATEMENT OF HON. RON WYDEN,  
A U.S. SENATOR FROM OREGON

In early August, the Finance Committee released the final report on its bipartisan investigation into the IRS's processing of applications from for tax-exempt status. Our investigation looked back at the period between 2010 and 2013. The committee reviewed 1½ million pages of e-mails and documents and conducted interviews with more than 30 IRS officials.

Our investigation found alarming bureaucratic dysfunction. Many applicants for tax-exempt status were treated badly and deserved much better service from their government. For example, between 2010 and late 2011, a total of 290 applications for tax-exempt status had been set aside for review. Only two applications had been resolved successfully. Not 200—two. That was unacceptable mismanagement. The investigation, however, did not find any evidence of criminal wrongdoing.

Chairman Hatch and I both took time to speak about our views on the Senate floor when the report came out. The focus of today's hearing, however, is what the IRS is doing to guarantee, once and for all, that this type of deeply troubling mismanagement never happens again.

The Finance Committee's report included 36 recommendations—18 bipartisan, 12 Democratic, and 6 Republican. Among them were proposals to:

- Set minimum training standards for managers in the exempt organization of-fice to ensure those employees can adequately perform their duties.
- Institute a standard policy that employees must reach a decision on all tax-exemption applications within 270 days of when they're filed.
- Create a position with the Taxpayer Advocate's office dedicated solely to helping organizations applying for tax-exempt status, and many others.

I want to thank Commissioner Koskinen for responding to those recommendations in a letter sent last month to me and Chairman Hatch. My takeaway from the letter is that the commissioner sees genuine progress being made to clean up the mess, and I look forward to hearing more about it today.

While Commissioner Koskinen is here, I also want to address the problem that occurred in Martinsburg, WV. Low-level IRS employees in Martinsburg deleted backup tapes that likely contained e-mails that were within the scope of the committee's investigation while it was ongoing.

This mistake was completely unacceptable and inexcusable, and there are reports that there was some lying afterward. This cannot happen again. I want to hear what the IRS is doing to fix it.

Finally, on Friday the committee received a detailed letter from the Department of Justice concerning their investigation into this matter, and I ask unanimous consent it be entered into the record.

Thank you, Commissioner, for being here today. It's my hope that the committee will have a productive debate about how best to guarantee that the kind of bureaucratic bumbling uncovered in our investigation will never recur.

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**U.S. Department of Justice**

Office of Legislative Affairs

*Office of the Assistant Attorney General**Washington, D.C. 20530*

October 23, 2015

The Honorable Orrin G. Hatch  
 Chairman  
 Committee on Finance  
 U.S. Senate  
 Washington, DC 20510

The Honorable Ron Wyden  
 Ranking Member  
 Committee on Finance  
 U.S. Senate  
 Washington, DC 20510

Dear Mr. Chairman and Senator Wyden:

We write to inform you about the Department of Justice's criminal investigation into whether any IRS officials committed crimes in connection with the handling of tax-exemption applications filed by Tea Party and ideologically similar organizations. Consistent with statements from the Department of Justice (the Department) throughout the investigation, we are pleased to provide additional information regarding this matter now that we have concluded our investigation. In recognition of not only our commitment to provide such information in this case, but also the committee's interest in this particular matter, we now provide a short summary of our investigative findings.

In collaboration with the FBI and Treasury Inspector General for Tax Administration (TIGTA), the Department's Criminal and Civil Rights Divisions conducted an exhaustive probe. We conducted more than 100 witness interviews, collected more than 1 million pages of IRS documents, analyzed almost 500 tax-exemption applications, examined the role and potential culpability of scores of IRS employees, and considered the applicability of civil rights, tax administration, and obstruction statutes. Our investigation uncovered substantial evidence of mismanagement, poor judgment, and institutional inertia, leading to the belief by many tax-exempt applicants that the IRS targeted them based on their political viewpoints. But poor management is not a crime. We found no evidence that any IRS official acted based on political, discriminatory, corrupt, or other inappropriate motives that would support a criminal prosecution. We also found no evidence that any official involved in the handling of tax-exempt applications or IRS leadership attempted to obstruct justice. Based on the evidence developed in this investigation and the recommendation of experienced career prosecutors and supervising attorneys at the Department, we are closing our investigation and will not seek any criminal charges.

**The Investigation**

The Department's probe began in May 2013, following a TIGTA audit report revealing the IRS's mishandling of tax-exempt applications filed by groups it suspected to be involved in political activity. See TIGTA Audit Report, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review*, Ref. No. 2013-10-053 (May 14, 2013). TIGTA's audit report revealed that the IRS coordinated the review of applicants for tax-exemption under Internal Revenue Code Sections 501(c)(3) and 501(c)(4), which limit the amount of political activity in which such groups can engage. According to the audit report, one way in which the IRS identified groups for coordinated review was through politically focused keywords, such as "Tea Party," "9/12 Project," and "Patriots," and the inventory of applications identified for coordinated review was internally referred to as the "Tea Party cases." These applications were subjected to heightened scrutiny, including burdensome and unnecessary information requests, which caused significant processing delays. Although TIGTA's audit report detailed no evidence or allegation of discriminatory intent, its findings were unsettling and prompted the Department of Justice to initiate a criminal investigation. Our probe, which was managed by an experienced team of

career prosecutors and supervising attorneys from the Criminal Division's Public Integrity Section and Civil Rights Division's Criminal Section, in partnership with seasoned law enforcement agents from the FBI and TIGTA, spanned the better part of 2 years. As explained below, our investigation confirmed the TIGTA audit report's core factual findings and examined in detail what motivated the decisions leading to the IRS's handling of these tax-exempt applications.

At the investigation's outset, the Department took careful steps to preserve the possibility of criminal prosecution in the face of potential Fifth Amendment issues. Under the Fifth Amendment, statements obtained from Federal employees under threat of termination—a common occurrence in administrative investigations like the TIGTA audit—as well as evidence derived from those statements, cannot be used against such employees in a criminal prosecution. *Garrity v. New Jersey*, 385 U.S. 493, 497–98 (1967); *Kastigar v. United States*, 406 U.S. 441, 460 (1972). We therefore formed two teams—a prosecution team principally responsible for the criminal investigation, and a filter team responsible for shielding the prosecution team from statements and information that risked contaminating an otherwise viable criminal prosecution. Before the prosecution team was given access to fruits of the audit report, the filter team reviewed prior statements by IRS employees to TIGTA auditors to assess whether a court might deem them compelled under the Fifth Amendment, and evaluated the statements and evidence derived from these prior statements to determine whether they could be traced to sources independent from any potentially compelled statements. This prophylactic measure was further necessitated by IRS leadership's order to its employees to cooperate in the parallel congressional investigation, raising concerns that a court could deem statements given to congressional committees to have been compelled. In early October 2013, we determined that the filter procedure was no longer necessary and that any potential prosecution supported by the evidence would not be frustrated by a Fifth Amendment challenge.

The prosecution and filter teams conducted over 100 interviews. Top-level IRS officials, including former IRS Commissioner Douglas Shulman, former Acting IRS Commissioner Steven Miller, and former Exempt Organizations Director Lois Lerner, voluntarily participated in extensive interviews with the prosecution team, as did their close advisors and career managers and line-level revenue agents directly involved in processing tax-exempt applications. Some key witnesses were interviewed multiple times. No person interviewed during the investigation was made promises of non-prosecution in order to obtain their statements.

Throughout the investigation, not a single IRS employee reported any allegation, concern, or suspicion that the handling of tax-exempt applications—or any other IRS function—was motivated by political bias, discriminatory intent, or corruption. Among these witnesses were several IRS employees who were critical of Ms. Lerner's and other officials' leadership, as well as others who volunteered to us that they are politically conservative. Moreover, both TIGTA and the IRS's Whistleblower Office confirmed that neither has received internal complaints from IRS employees alleging that officials' handling of tax-exempt applications was motivated by political or other discriminatory bias.

In addition to conducting interviews, we also collected and reviewed voluminous relevant documents. On May 31, 2013, the Department served the IRS with a demand that it preserve all documents potentially material to the investigation, with the same obligations and subject to the same potential sanctions that would apply had the IRS been served a Federal grand jury subpoena. The IRS produced more than 1 million pages of unredacted documents and asserted no privileges against disclosure. The Department shared Congress's frustration with the IRS's revelation in June 2014 that its document collection and preservation process was susceptible to potentially catastrophic loss. Specifically, the IRS revealed that its electronic backup system for e-mails was vulnerable to the crash of a single employee's hard drive, which could result in the permanent loss of that employee's e-mail archive. Indeed, this is what occurred with respect to Ms. Lerner, whose hard drive crashed in June 2011, causing the destruction of her e-mail archives. Our confidence in the IRS's data collection process was further undermined by the 4-month delay in its disclosure of this information, as well as TIGTA's discovery that, in March 2014, IRS information technology employees inadvertently destroyed more than 400 electronic backup tapes that may have contained copies of Ms. Lerner's e-mails.

Despite these shortcomings, we are confident that we were able to compile a substantially complete set of the pertinent documents. The IRS collected documents from more than 80 employees—many more employees than were regularly and di-

rectly involved in the matters under investigation—making exceedingly remote the chance that a hard drive crash or other technical failure experienced by any particular employee could cause the permanent loss of any relevant e-mail or other document. Moreover, we did not rely exclusively on the IRS to collect documents. We also searched Ms. Lerner’s entire computer and Blackberry, obtained the complete e-mail boxes of IRS employees central to the investigation (as opposed to obtaining only those e-mails the IRS deemed responsive), and performed office searches of some officials. We also obtained documents directly from several witnesses. Our extensive witness interviews revealed no indication of any missing material documents, and no IRS witness reported seeing any documents that have since gone missing or are otherwise unaccounted for. Finally, as discussed more below, our investigation revealed no evidence that the IRS’s document collection and retention problems, Ms. Lerner’s hard drive crash, or the IRS’s delayed disclosure regarding these matters were caused by a deliberate attempt to conceal or destroy information.

The Department also obtained and reviewed the IRS’s tax-exempt-application files for nearly 500 groups that applied for status between 2009 and the release of the Audit Report in May 2013, which were subject to the IRS’s coordinated review regarding political activity. According to an analysis by the FBI, nearly 70 percent of the applications coordinated for review were submitted by right-leaning groups, including the Tea Party, confirming the TIGTA audit’s finding that such groups were disproportionately impacted by the IRS’s coordinated review of applications. We identified groups suffering the most significant of the impacts of these procedures and obtained interviews with representatives of 11 of them. Some of these interviews were obtained through lawyers, including a firm representing as many as 50 individual organizations. Although not all of these represented organizations agreed to be interviewed, their lawyers either informed us that the information provided by organizations whose representatives did agree to be interviewed was sufficient to further the Department’s criminal investigation, or provided detailed information about their clients’ interactions with the IRS. In addition, we had the benefit of reviewing the detailed complaints filed in civil cases lodged in the District of Columbia and Southern District of Ohio, as well as reviewing public testimony from applicants who appeared before Congress to describe their interactions with the IRS.

### **Investigative Findings**

In order to bring criminal charges, we must have evidence of criminal intent. The Department searched exhaustively for evidence that any IRS employee deliberately targeted an applicant or group of applicants for scrutiny, delay, denial, or other adverse treatment because of their viewpoint. Intentional viewpoint discrimination may violate civil rights statutes, which criminalize acting under color of law to willfully deprive a person of rights protected by the Constitution or Federal law. *See* 18 U.S.C. §§ 241, 242. Intentional viewpoint discrimination may also violate criminal tax statutes that prohibit IRS employees from committing willful oppression under color of law, for example by deliberately failing to perform official duties with the intent of defeating the due administration of revenue laws, or by corruptly impeding or obstructing the administration of the Tax Code. *See* 26 U.S.C. §§ 7214(a)(1), 7214(a)(3), 7212(a). These statutes require proof beyond a reasonable doubt that an IRS official specifically intended to violate the Constitution, tax code, or another Federal law.

As applied to this case, a criminal prosecution under any of these statutes would require proof that an IRS official intentionally discriminated against an applicant based upon viewpoint. It would be insufficient to prove only that IRS employees used inappropriate criteria to coordinate the review of applications, acted in ways that resulted in the delay of the processing applications, or disproportionately subjected some applicants to burdensome or unnecessary questions. Instead, we would have to prove that such actions were undertaken for the very purpose of harassing or harming applicants. Proof that an IRS employee acted in good faith would be a complete defense to a criminal charge; and proof that an IRS employee acted because of mistake, bad judgment, ignorance, inertia, or even negligence would be insufficient to support a criminal charge.

Our investigation found no evidence that any IRS employee acted with criminal intent. We analyzed the culpability of every IRS employee who played a role in coordinating for review applications or handling them afterwards, from line-level revenue agents and managers in the Cincinnati-based Determinations Unit, to tax law specialists and senior executive officials based in Washington, DC. Apart from the belief by many tax-exempt applicants affiliated with the Tea Party and similar ideologies that they had been targeted, we found no evidence that any IRS employee



intentionally discriminated against these groups based upon their viewpoints. To the contrary, the evidence indicates that the decisions made by IRS employees, though misdirected, were motivated by the desire to treat similar applications consistently and avoid making incorrect decisions. Their plans to treat applications consistently were poorly implemented, due to a combination of ignorance about how to apply section 501(c)(4)'s requirements to organizations engaged in political activity, lack of guidance from subject matter experts about how to make decisions in an area most witnesses described as difficult, and repeated communication and management issues. Moreover, many employees failed to engage in critical thought about the effect their actions (or inactions) would have upon those who applied for tax-exempt status. We found that many IRS employees' failure to give adequate attention to the applications at issue was caused by competing demands on their time and an unwillingness to be held accountable for difficult decisions over sensitive matters. We did not, however, uncover any evidence that any of these employees were motivated by intentional viewpoint discrimination.

As noted above, no IRS employee we interviewed, from those directly involved in decision making to those who were primarily witnesses to the conduct of others, reported having any information suggesting that any action taken by any person in the IRS was done for the purpose of harming or harassing applicants affiliated with the Tea Party or similar groups. These witness accounts are fully supported by contemporaneous internal IRS documents, which do not suggest that there was a partisan political motive for any of the decisions made during the handling of the applications. Moreover, any inference of specific intent that might be drawn from the length of the delay in processing applications, the burdensomeness of the information requests, or the fact that Tea Party and ideologically similar organizations were disproportionately affected by the IRS's coordination efforts, is contradicted by witnesses' explanations of why IRS employees made the decisions that they did, all of which—even if misguided—are inconsistent with criminal intent.

Importantly, our investigation revealed that this was not the first time that the IRS had used inept labels in organizing their review of applications. Prior to the IRS procedures that were the subject of our investigation, the IRS had historically coordinated review of applications based on the applicant's name and affiliations, including using keywords such as "progressive" and "ACORN." This historical practice creates a substantial barrier to establishing criminal intent, and bolsters the conclusion that IRS employees did not believe that coordinating for review applications using words like "Tea Party" could potentially violate the Constitution or the tax code, or that this method of coordinating applications for review was discriminatory or otherwise inappropriate. Moreover, the decision to coordinate the review of applications and the discussions about how to handle them were conducted openly across multiple IRS components and among many different employees with a range of political views, including some who voluntarily identified themselves in interviews as conservative or Republican. Such open discussion of planned actions is inconsistent with criminal intent.

The evidence that we developed demonstrated a disconnect between employees in Cincinnati, who were principally responsible for identifying the applications for review and crafting the burdensome information requests, and employees in Washington, DC, who were principally responsible for the delay and failure to provide guidance on how to handle the application backlog despite repeated requests that they do so from revenue agents and their supervisors in Cincinnati. As a result, no one person (or group of people) was responsible for the chain of events that resulted in the manner in which applications were ultimately coordinated for review and then delayed. Instead, we found overwhelming evidence that the ill-advised selection criteria, burdensome information requests, and application delays were the product of discrete mistakes by line-level revenue agents, technical specialists, and their immediate supervisors, and that those mistakes were exacerbated by oversight and leadership lapses by senior managers and senior executive officials in Washington, DC. We developed no evidence that the decisions IRS employees made about how to handle applications, either in Cincinnati or Washington, were motivated by discriminatory intent or other corrupt motive.

The one official who, by virtue of her role as Director of the IRS's Exempt Organizations Division, arguably had the most oversight responsibility for all tax-exempt applications, was Ms. Lerner. Due to her position, and because the U.S. House of Representatives Ways and Means Committee referred civil rights allegations against her to the Department on April 9, 2014, we took special care to evaluate whether Ms. Lerner had criminal culpability. The need for scrutiny of Ms. Lerner in particular was heightened by the discovery and publication of e-mails from her

official IRS account that expressed her personal political views and, in one case, hostility towards conservative radio personalities. We therefore specifically considered whether Ms. Lerner's personal political views influenced her decisions, leadership, action, or failure to take action with respect to tax-exempt applications or any other matter. We found no such evidence.

Our conclusion regarding Ms. Lerner is supported by several factors. First, not a single IRS employee that we interviewed, some of whom were critical of Ms. Lerner's leadership and general management style, and some of whom volunteered that they consider themselves politically conservative, witnessed, alleged, or suspected that Ms. Lerner acted with a political, discriminatory, corrupt, or other inappropriate purpose.

Second, our investigation revealed that when Ms. Lerner became fully aware of and focused on the Cincinnati-based Determinations Unit's use of inappropriate criteria, she recognized that it was wrong, ordered that it stop immediately, and instructed subordinates to take corrective action. In fact, Ms. Lerner was the first IRS official to recognize the magnitude of the problem and to take concerted steps to fix it. To the extent that Ms. Lerner mishandled the oversight of how these tax-exempt applications were processed, it resulted from her failure to digest materials available to her from which she could have identified the problem sooner, and her delegation of corrective action to subordinates whom she did not adequately supervise to assure that her directions were implemented sufficiently.

Third, although Ms. Lerner exercised poor judgment in using her IRS e-mail account to exchange personal messages that reflected her political views, we cannot show that these messages related to her official duties and actions with respect to the handling of these tax-exempt applications. In fact, we uncovered no e-mail or other communication showing that Ms. Lerner exercised her decision-making authority in a partisan manner generally, or in the handling of tax-exempt applications specifically, and no witness we interviewed interpreted any e-mail or other communication they exchanged with Ms. Lerner in such a manner.

Finally, our investigation uncovered no evidence that Ms. Lerner intentionally caused her hard drive to crash or that she otherwise endeavored to conceal documents or information from IRS colleagues or this investigation. Moreover, it bears noting that Ms. Lerner cooperated fully with our investigation, voluntarily sitting for approximately 12 hours of interviews with no promise of immunity, producing e-mails and documents upon request, and disclosing passwords to her IRS Blackberry to assist in searching its contents.

We also carefully considered whether any IRS official attempted to obstruct justice with respect to their reporting function to Congress, the collection and production of documents demanded by the Department and Congress, the delayed disclosure of the consequences of Ms. Lerner's hard drive crash, or the March 2014 erasure of electronic backup tapes. *See, e.g.*, 18 U.S.C. §§ 1503, 1512, 1515, 1519. At a minimum, these statutes would require us to prove a deliberate attempt to conceal or destroy information in order to improperly influence a criminal or congressional investigation. We uncovered no evidence of such an intent by any official involved in the handling of tax-exempt applications or the IRS's response to investigations of its conduct.<sup>1</sup> Although the IRS's decision to delay the disclosure of the consequences of Ms. Lerner's hard drive crash for more than 4 months undermined confidence in its judgment, it was not criminal. The evidence shows that IRS attorneys and officials spent that time exercising due diligence to determine what had occurred, mitigating heavily against criminal intent. Similarly, the evidence shows that IRS officials in Washington were unaware of the March 2014 erasure of electronic backup tapes until it was brought to their attention by TIGTA in June 2015. Although those backup tapes should have been protected from erasure due to the

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<sup>1</sup>TIGTA has developed evidence that, in June 2015, GS Grade 4 employees and their supervisor working at the IRS's Enterprise Computing Center may have made misleading statements to TIGTA about the manner in which electronic server hard drives were inventoried. There is no evidence suggesting that the employees were involved in the handling of tax-exempt applications, intended to conceal information about the IRS's handling of tax-exempt applications, or that they acted at the behest of any of the IRS employees involved in the handling of tax-exempt applications. Rather, the evidence suggests that the employees failed to inventory the server hard drives properly and later sought to avoid being held accountable for that failure. The Criminal Division's Public Integrity Section and the Civil Rights Division's Criminal Section determined that the possibly misleading statements had no adverse impact on the Department's criminal investigation of the handling of tax-exempt applications. TIGTA has informed the Department that it intends to refer this matter to a U.S. Attorney's Office.

Department's preservation demand, there is no evidence that any IRS employee intended to conceal the backup tapes from our investigation or realized that erasing them might violate the preservation demand. There is no basis for any obstruction of justice charge arising from the IRS's data collection and preservation protocol.

#### **Conclusion**

The IRS mishandled the processing of tax-exempt applications in a manner that disproportionately impacted applicants affiliated with the Tea Party and similar groups, leaving the appearance that the IRS's conduct was motivated by political, discriminatory, corrupt, or other inappropriate motive. However, ineffective management is not a crime. The Department of Justice's exhaustive probe revealed no evidence that would support a criminal prosecution. What occurred is disquieting and may necessitate corrective action—but it does not warrant criminal prosecution.

We hope this information is helpful. We have made a substantial effort to provide detailed information regarding our findings in this letter, and would be pleased to offer a briefing to address any questions you may have on this matter. Please do not hesitate to contact this office if we may provide additional assistance regarding this or any other matter.

Sincerely,

Peter J. Kadzik  
Assistant Attorney General

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COMMUNICATION

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Washington, DC 20036

**United States Senate  
Committee on Finance**

*Statement for the Record*

**Stephen Spaulding  
Senior Policy Counsel and Legal Director**

*For the Hearing*

**“The Internal Revenue Service’s Response to Committee Recommendations  
Contained in Its August 5, 2015 Report”**

**October 27, 2015**

Chairman Hatch and Ranking Member Wyden, thank you for the opportunity to submit this statement for the record.

Last week, the Department of Justice concluded its investigation in connection with the handling of tax-exempt applications filed by new social welfare organizations and “found no evidence that any IRS official acted based on political, discriminatory, corrupt, or other inappropriate motives.”<sup>1</sup>

Instead, as this testimony explains, we believe much of this controversy erupted because of vague IRS rules governing political activities of tax exempt entities under Section 501(c) of the Internal Revenue Code—and in particular, social welfare organizations. Their lack of clarity, coupled with a substantial increase in tax-exempt organization applications post-*Citizens United*, hobbled compliance and enforcement.

To be clear: it was wrong for the IRS to subject some “social welfare” nonprofit applications to extra scrutiny based solely on their names and identified interests. In keeping with the findings of this Committee’s bipartisan report, the agency should take action to ensure these mistakes are not repeated.

**Specifically, the IRS and Treasury Department should write new rules that are consistent with the Internal Revenue Code, clarify what constitutes political activity under the tax laws, and clearly state that social welfare organizations can spend no more than an insubstantial amount of their resources on political activity.**

The real scandal—hundreds of millions of secret dollars in our elections funneled through a handful of social welfare organizations—stems from a powerful combination of at least four factors: (1) a lack of bright line standards about what constitutes partisan political activity, including how much political activity social welfare organizations may engage in, and how to measure it; (2) the brazen willingness of political consultants to exploit and manipulate the rules governing social welfare organizations by operating them as *de facto* political committees; (3) an under-

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<sup>1</sup> Letter from Peter J. Kadzik (Assistant Attorney General) to Rep. Bob Goodlatte and Rep. John Conyers (Oct. 23, 2015), available at <http://online.wsj.com/public/resources/documents/IRS1023.pdf>.

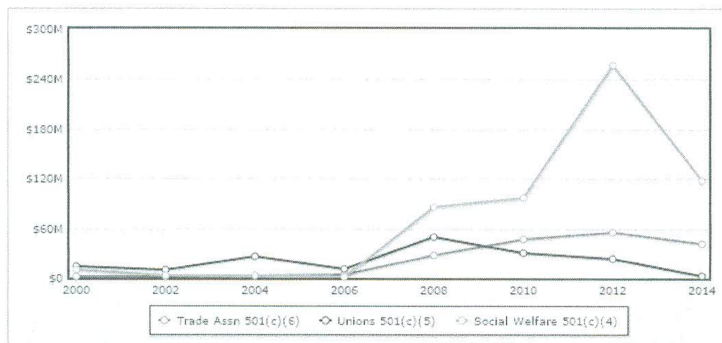
resourced agency that has thus far failed to do its job to hold the largest offenders accountable; and (4) champions of gridlock who have blocked Congress from considering comprehensive disclosure legislation in the wake of *Citizens United*.

If the IRS fails to move forward in its rulemaking as discussed above, major political groups will continue to masquerade improperly as social welfare nonprofits under Section 501(c)(4)—solely to keep political spenders anonymous. This deprives the American people of the information they need about who is trying to influence their votes, and to whom their elected officials may owe a debt of gratitude after Election Day.

Up to and including the 2006 election cycle, social welfare groups spent little on partisan political activity. Then, a series of court decisions dramatically changed the status quo. First, the Supreme Court's 2007 decision in *FEC v. Wisconsin Right to Life* lifted prohibitions on corporate spending for election-related communications except for express advocacy and its functional equivalent.<sup>2</sup> That led to a sharp increase in spending on electioneering communications by nonprofit groups that do not disclose their donors. A far larger increase came after the Supreme Court's 2010 decision in *Citizens United* struck down all prohibitions on corporate election-related independent, outside spending.<sup>3</sup> Combined with the D.C. Circuit's opinion in *SpeechNow.org v. FEC*, these decisions led to an explosion in outside election spending.<sup>4</sup> It topped \$1 billion in the 2012 elections and over \$500 million in the 2014 midterms.<sup>5</sup>

With this increased spending came increased secrecy about who is financing these political expenditures and, consequently, a less-informed electorate. Approximately one-third of the outside money in the 2012 and 2014 federal elections came from secret sources, to the tune of \$481 million, of which spending by social welfare nonprofits accounted for approximately \$375 million.<sup>6</sup> These numbers, though staggering, underestimate the total spent by these organizations to influence campaigns, because they only include the money spent on federal, and not state, elections. The amounts also exclude money that funds communications that fall short of express advocacy outside of the electioneering communications windows but are clearly intended to influence elections.

### 501(c) Spending, Cycle Totals, by Type



Source: Center for Responsive Politics, [http://www.opensecrets.org/outsidespending/nonprof\\_summ.php](http://www.opensecrets.org/outsidespending/nonprof_summ.php) (last accessed Oct. 26, 2015).

<sup>2</sup> 551 U.S. 449 (2007).

<sup>3</sup> 558 U.S. 310 (2010).

<sup>4</sup> 599 F.3d 686 (2010); Richard L. Hasen, *The Numbers Don't Lie*, SLATE, Mar. 9, 2012, [http://www.slate.com/articles/news\\_and\\_politics/politics/2012/03/the\\_supreme\\_court\\_s\\_citizens\\_united\\_decision\\_has\\_led\\_to\\_an\\_explosion\\_of\\_campaign\\_spending.html](http://www.slate.com/articles/news_and_politics/politics/2012/03/the_supreme_court_s_citizens_united_decision_has_led_to_an_explosion_of_campaign_spending.html) (last accessed Oct. 26, 2015).

<sup>5</sup> Center for Responsive Politics, *Outside Spending by Cycle*, <http://www.opensecrets.org/outsidespending/index.php> (last accessed Oct. 26, 2015).

<sup>6</sup> Center for Responsive Politics, *Outside Spending by Disclosure, Excluding Party Committees*, <http://www.opensecrets.org/outsidespending/disclosure.php> (last accessed Oct. 26, 2015); Center for Responsive Politics, *501(c) Spending, Cycle Totals, by Type*, [http://www.opensecrets.org/outsidespending/nonprof\\_summ.php](http://www.opensecrets.org/outsidespending/nonprof_summ.php) (last accessed Oct. 26, 2015).

As election-related spending by social welfare organizations soared after *Citizens United* and *SpeechNow.org*, so did the number of applications from groups seeking 501(c)(4) tax-exempt status. They nearly doubled between 2010 and 2012, from 1,735 in 2010 to 3,357 in 2012.<sup>7</sup> Although social welfare organizations may self-declare without submitting a formal application to the IRS, the optional approval process provides them with more certainty that their operations will not jeopardize their tax-exempt status.

Congress never intended for social welfare organizations to exist as conduits for secret political spending. In exchange for their tax exemption, the law requires these nonprofits to engage “exclusively” in the promotion of social welfare.<sup>8</sup> The IRS has said social welfare activities do not include political campaign intervention.<sup>9</sup> IRS regulations muddled the waters with a primary purpose analysis that is inconsistent with the exclusivity requirement of the Internal Revenue Code.<sup>10</sup>

Today, no bright line IRS standard exists as to how much and by what measure the IRS should evaluate a social welfare organization’s furtherance of its primary purpose. As the IRS has explained, “no precise definition exists in relevant revenue rulings, cases or regulations” to decide if an organization is “‘primarily’ engaged in social welfare activities.”<sup>11</sup> This may “often requir[e] a sophisticated legal and complex factual review to evaluate the application.”<sup>12</sup> We are left with a vague “facts and circumstances” test that invites inconsistent enforcement of the law. Even when applied properly, some political groups are out of compliance with the existing flawed regulations.

In the wake of *Citizens United*, this discrepancy—coupled with a lack of enforcement—has paved the way for several high-profile partisan political organizations on the right and left to pose as social welfare organizations and spend tens of millions of dollars from undisclosed sources on elections. Ultimately, it is the secrecy that social welfare nonprofits provide to donors that makes them attractive vehicles for political spending, and all the more reason why Americans expect the IRS to do its job and enforce the law.

Citing their campaign spending and public reports about their operations, some campaign finance reform advocates have urged the IRS to investigate groups on the left like Priorities USA and on the right like Crossroads GPS to gauge whether they are in fact organizations that exist primarily to influence candidate election outcomes.<sup>13</sup>

Just last week, the Center for Responsive Politics released a report showing how one purported social welfare organization—“Carolina Rising”—spent 97 percent of the almost \$5 million it raised in 2014 in support of a single victorious Senate candidate.<sup>14</sup>

As of today, the IRS has done little to hold the most flagrant violators accountable, despite reams of evidence that their overriding purpose appears to be to provide anonymity for donors eager to spend unlimited amounts of money supporting and attacking candidates for public office.<sup>15</sup>

This troubling trend shows no sign of stopping in 2016. According to the *New York Times*, supporters of former Secretary of State Hillary Rodham Clinton are consid-

<sup>7</sup>TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW 3 (2013).

<sup>8</sup>26 U.S.C. § 501(c)(4).

<sup>9</sup>Treas. Reg. § 1.501(c)(4)–(1)(a)(2)(ii).

<sup>10</sup>Treas. Reg. § 1.501(c)(4)–(1)(a)(2)(i).

<sup>11</sup>IRS, CHARTING A PATH FORWARD AT THE IRS: INITIAL ASSESSMENT AND PLAN OF ACTION 25 (2013).

<sup>12</sup>*Id.* at 22.

<sup>13</sup>See Letter from J. Gerald Hebert, Executive Director, Campaign Legal Center and Fred Wertheimer, President, Democracy 21 to the IRS, September 28, 2011, available at [http://www.democracy21.org/wp-content/uploads/2014/05/9-28-2011-Letter\\_to\\_the\\_IRS\\_from\\_Democracy\\_21\\_and\\_Campaign\\_Legal\\_Center.pdf](http://www.democracy21.org/wp-content/uploads/2014/05/9-28-2011-Letter_to_the_IRS_from_Democracy_21_and_Campaign_Legal_Center.pdf).

<sup>14</sup>Robert Maguire, “Political Nonprofit Spent Nearly 100 Percent of Funds to Elect Tillis in 2014,” CENTER FOR RESPONSIVE POLITICS, <https://www.opensecrets.org/news/2015/10/political-nonprofit-spent-nearly-100-percent-of-funds-to-elect-tillis-in-14/> (last accessed Oct. 24, 2015).

<sup>15</sup>Democracy 21 and the Campaign Legal Center have sent at least 11 letters to the IRS, thoroughly documenting the extent of Crossroads GPS’s campaign activity and its legal argument for why the IRS should deny Crossroads GPS’s social welfare status and assess penalties for any violations of the law. They sent letters on May 6, 2014; January 2, 2013; September 27, 2012; July 23, 2012; May 24, 2012; April 17, 2012; March 22, 2012; March 9, 2012; December 14, 2011; September 28, 2011; and October 5, 2010 which will be provided to the Committee as an appendix.

ering activating a 501(c)(4) to support her run for the White House.<sup>16</sup> On the Republican side, most of the candidates “have aligned with nonprofit groups to raise hundreds of millions of dollars,” including at least one that has already planned a \$1 million advertising campaign in support of one of the individuals running for the nomination.<sup>17</sup>

Voters deserve to know who is attempting to influence their votes and who is speaking to them. Disclosure allows them to evaluate the strength, content, and agenda of political messages, and is an important tool to hold representatives accountable to their interests instead of those of financial backers. That is why courts have repeatedly upheld disclosure requirements.<sup>18</sup>

Specifically, the Supreme Court ruled 8–1 in *Citizens United* that disclosure by outside spending groups “permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency [in political spending] enables the electorate to make informed decisions and give proper weight to different speakers and messages.”<sup>19</sup> *Citizens United* reaffirmed prior campaign finance cases that upheld disclosure requirements, citing “evidence in the record that independent groups were running election-related advertisements while hiding behind dubious and misleading names.”<sup>20</sup>

Consistent with this important First Amendment value—an informed electorate—the law requires Super PACs and other Section 527 organizations to disclose their donors when they spend money to influence elections. **Political operatives should not circumvent the constitutionally sound bed rock policy of disclosure by exploiting inconsistent enforcement and vague regulations governing organizations that Congress never anticipated would engage in election-related spending.**

Impartial and consistent enforcement of the law governing nonprofit political spending is squarely within the IRS’s mandate and authority. The IRS and Treasury Department took the important step in 2013 of issuing a notice of proposed rulemaking, recognizing that both the public and the government “would benefit from clearer definitions” of campaign-related political activity.<sup>21</sup> This action was in keeping with one of the recommendations in the Treasury Inspector General for Tax Administration’s (TIGTA) report on the IRS’s use of in appropriate criteria to select social welfare applications for review.<sup>22</sup> Importantly, TIGTA recommended that “guidance on how to measure the ‘primary activity’ of . . . 501(c)(4) social welfare organizations be included for consideration in the Department of the Treasury Priority Guidance Plan.”<sup>23</sup>

The IRS and Treasury Department’s notice of proposed rulemaking was a critical first step to solve the problem and protect the integrity of our tax laws. Still, the proposal had significant flaws. Common Cause—along with over 27,000 of our members who have signed our petition—continue to urge the IRS to release a second proposed rule for comment. We are filing over 5,000 more comments from Common Cause members this week, urging a new rule consistent with the policy outlined in this statement for the record.

It is essential that the next proposed rule establish a low limit on the amount of campaign activity a group can engage in consistent with the Internal Revenue Code. In keeping with court precedent, new commonsense regulations should allow an insubstantial amount of activity that is unrelated to a 501(c)(4)’s social welfare purpose without jeopardizing the organization’s tax-exempt status. Such a rule would permit a small amount of candidate-related political activity, so long as it is not more than an insubstantial part of its activities.

<sup>16</sup>Eric Lichtblau, “IRS Expected to Stand Aside as Nonprofits Increase Role in 2016 Race,” N.Y. TIMES, July 5, 2015, available at <http://www.nytimes.com/2015/07/06/us/politics/irs-expected-to-stand-aside-as-nonprofits-increase-role-in-2016-race.html>.

<sup>17</sup>See *id.*

<sup>18</sup>See Letter from Fred Wertheimer, President, Democracy 21 and Trevor Potter, President, Campaign Legal Center to Senators, Nov. 14, 2013, available at <http://www.democracy21.org/up-content/uploads/2013/11/LETTER-TO-HSE-AND-SENATE-ON-COURTS-REJECTING-CHALLENGES-TO-DISCLOSURE-FINAL-11-13-13.pdf>.

<sup>19</sup>*Citizens United*, 558 U.S. at 371.

<sup>20</sup>*Id.* at 367.

<sup>21</sup>Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71535 (proposed Nov. 29, 2013) (to be codified at 26 CFR pt. 1).

<sup>22</sup>TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW 17 (2013).

<sup>23</sup>*Id.*



To influence elections, an organization could establish a Section 527 organization, which requires disclosure, for all other election-related expenditures. This appears to be what the Senate expected when it enacted Section 527 in the first place.<sup>24</sup>

We recognize that the IRS funding levels have fallen steadily from \$13.4 billion in 2010 to \$10.9 billion in 2015—a one-fifth reduction in funding, adjusting for inflation.<sup>25</sup> This hobbles meaningful action and forces the IRS to rethink its priorities. Senate appropriators proposed another cut in the FY16 Financial Services appropriations bill, reducing the IRS's funding another \$470 million, to \$10.4 billion.<sup>26</sup> The IRS should not use these budgetary constraints to justify a green light for continued misuse of social welfare organizations.

Of course, Congress could enact a more robust disclosure regime to respond to the new landscape post-*Citizens United*. Senators, including the ranking member of this Committee, have introduced bills that would stem the tide, including the DISCLOSE Act (S. 229) and the Follow the Money Act (S. 791 (113th Cong.)). The DISCLOSE Act has been subjected to repeated filibusters in past years and has not had as much as a hearing during this Congress, unfortunately. Still, as discussed above, the IRS should enforce the law as written and enact regulations consistent with the exclusivity requirements of the Internal Revenue Code and later case law.

The use of inappropriate criteria to single out some social welfare applicants for scrutiny does not justify an abrogation of the agency's duty to enforce the law fairly and impartially in the first place. The IRS should hold political groups on the right and the left accountable if they misappropriate the privileges of the social welfare organization's structure. The IRS should bring its regulations in line with the Internal Revenue Code, while watchdogging blatant efforts to violate even the flawed rules.

Thank you, Mr. Chairman, for the opportunity to submit this statement.



<sup>24</sup> Senate Rep. No 93–1357, 93rd Cong. 2d Sess. (Dec. 16, 1974), reprinted in 1974–1 Cum. Bull. 517, 534; Miriam Galston, *Vision Service Plan v. U.S.: Implications for Campaign Activities of 501(c)(4)s*, 53 EXEMPT ORGANIZATION TAX REVIEW 165 (2006).

<sup>25</sup> Brandon DeBot and Chuck Marr, *Poor IRS Service Reflects Congress's Deep Funding Cuts* (June 1, 2015), Center for Budget and Policy Priorities, available at <http://www.cbpp.org/sites/default/files/atoms/files/6-1-15tax.pdf>.

<sup>26</sup> Press release, Senate Committee Agrees to FY2016 Financial Services Appropriations Bill, July 23, 20 15, available at <http://www.appropriations.senate.gov/news/majority/senate-committee-agrees-to-fy2016-financial-services-appropriations-bill>.