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TE/GE

Advisory Committee on
Tax Exempt and Government Entities (ACT)

2015 Report of Recommendations

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Member Biographies

EMPLOYEE PLANS

Alison Cohen, Atlanta, GA
Ms. Cohen is a Senior Associate with the Ferenczy Benefits Law Center assisting clients with many different issues relating to qualified retirement plans and specializing in the Employee Plans Compliance Resolution System (EPCRS) corrections. She has 18 years of experience working with retirement plans. From plan operations to presentations and sales, to resolution of complex legal issues, Cohen has broad experience and knowledge of the real world of retirement plan law. Cohen received a B.A. in Political Science from Rice University, Houston, and a Juris Doctorate from the University of San Diego School of Law, San Diego.

Donna Mueller, Des Moines, IA
Ms. Mueller has been the CEO of the Iowa Public Employees' Retirement System (IPERS) since January 2003. IPERS has over 340,000 members, almost 2,200 participating employers, and assets that exceed $24 billion. She was previously the Executive Director of the Boston Retirement System. Ms. Mueller received a Juris Doctor in law from Washington and Lee University in Lexington, Virginia, and a Bachelor of Arts in political science from the University of Minnesota in Duluth. She is a graduate of the John F. Kennedy School of Government's Program for Senior Executives at Harvard University. She is a past-president of the National Association of State Retirement Administrators and is a member of the Internal Revenue Service's Advisory Committee on Tax Exempt and Government Entities (ACT).

David A. Mustone, McLean, VA
Mr. Mustone is partner at Hunton & Williams LLP advising employers on tax, ERISA and labor law aspects of employee benefits law. His clients include for-profit employers (both publicly traded and privately held) and a variety of nonprofit and governmental employers. He is co-chair for separate IRS liaison groups on determination letter and correction programs for tax qualified plans. He served as a senior attorney in the IRS Office of Chief Counsel. Mr. Mustone received a Bachelor of Arts in Government from the University of Notre Dame, Notre Dame, Ind.; and a Juris Doctorate and LL.M in Taxation from the National Law Center, George Washington University, Washington, D.C.

Christopher W. Shankle, Shreveport, LA
Mr. Shankle is a Retirement Services Specialist at Capital One in Shreveport. He works on a broad array of employee benefits issues, including retirement plan administration, testing and disclosure. For the last five years, he has led an American Institute of Certified Public Accountants (AICPA) technical resource panel on employee benefit plans monitoring legislative and regulatory activity. Mr. Shankle has been involved in numerous outreach initiatives on employee benefits issues. He has a bachelor's degree in accounting from the University of Mississippi and is a licensed CPA in Mississippi and Louisiana.

Stuart A. Sirkin, Washington, DC
Mr. Sirkin is a benefits lawyer with The Segal Company. His prior positions include senior positions in the pension offices of the IRS, the Department of Labor and the Pension Benefit Guaranty Corporation (PBGC). Mr. Sirkin also was on the staff of the Senate Finance Committee, as well as with consulting and law firms. He is active in the American Bar Association employee benefit committees and a charter member of the American College of Employee Benefits Counsel. Sirkin received a B.A. in Economics from George Washington University, Washington, D.C.; a Masters in Labor Economics from Cornell University, Ithaca, N.Y.; a Juris Doctorate from Columbia University Law School, New York, and a Masters in Tax Law from the Georgetown University Law Center, Washington, D.C.

Matthew I. Whitehorn, Philadelphia, PA
Mr. Whitehorn is a partner and chair of the employee benefits group at Dilworth Paxson LLP in Philadelphia. He has more than 25 years experience working with qualified and non-qualified plans including 457 plans, deferred compensation plans and 403(b) plans. Whitehorn co-chairs the Philadelphia Bar Association's employee benefits committee. Whitehorn has a B.A. in History from The Johns Hopkins University, a J.D. from Villanova University and an LL.M. in Taxation from Temple University School of Law.

EXEMPT ORGANIZATIONS

Virginia Gross, Kansas City, MO
Ms. Gross is a shareholder with Polsinelli PC concentrating her practice on nonprofit and tax-exempt organizations law. Virginia counsels nonprofit organizations on all aspects of tax-exempt organizations law, such as the formation, qualification, activities, and business ventures of nonprofit organizations. She advises nonprofit clients on issues regarding their operations, fundraising practices, grant-making, unrelated business income planning, joint venturing and partnering, and the use of supporting organizations and for-profit subsidiaries. Clients include charitable and educational organizations, private foundations, healthcare entities, associations, supporting organizations, social welfare organizations, and social clubs. Virginia works with numerous nonprofit boards of directors and trustees regarding governance and best practices matters and is a frequent writer and speaker on nonprofit law topics. She earned her J.D. from the University of Texas and her B.S. from Texas A&M University and is listed in Best Lawyers in America for Nonprofit Organizations/Charities Law for 2008-2015.

Amy Coates Madsen, Baltimore, MD
Ms. Madsen is the director of the Standards for Excellence Institute, a program of the Maryland Association of Nonprofit Organizations. She specializes in nonprofit organization management and governance issues and works with organizations of all sizes and mission areas. Madsen received her Bachelor of Arts degree at Virginia Polytechnic Institute and State University, and her Masters of Arts in Policy Studies at Johns Hopkins University.

David Moja, Orlando, FL
Mr. Moja is a Partner and National Director of Not-for-Profit Tax Services at Capin Crouse LLP. With 28 years of accounting experience, he has worked both inside not-for-profit organizations and for public accounting firms. Mr. Moja has extensive experience serving colleges and universities, associations, global missions organizations, churches, chambers of commerce, children's advocacy groups and environmental organizations. He has spoken extensively on tax-exempt organization issues to a wide variety of groups and conducts regular webcasts on exempt organizations issues. He is a licensed CPA in Florida, Georgia and Colorado and received a B.S. in Accounting from Florida State University, Tallahassee.

Andrew Watt, Arlington, VA

Mr. Watt is the president and CEO of the Association of Fundraising Professionals based in Arlington, representing individuals and organizations that raise more than $100 billion in charitable contributions every year around the world for countless causes. Named president in 2011, he has worked for the nonprofit community since the early 1990s. He serves on the board of directors for AFP, the AFP Foundation for Philanthropy and the AFP Foundation for Philanthropy–Canada. From 1993 to 2005 Mr. Watt was employed by a similar organization in Britain. He has international experience, fundraising expertise and experience with small/medium nonprofits. Mr. Watt has served on the Public Policy Committee of Independent Sector since 2012. He has served as both a volunteer and board member of many nonprofit organizations. He sits on the board of the National Philanthropic Trust – UK and is currently chairman of the American Friends of Winchester College. Mr. Watt was an adjunct faculty member of St. Mary's University of Minnesota from 2007 – 2012 where he taught on the globalization of philanthropy. He received his B.A. at the University of Edinburgh.

Gary J. Young, Boston, MA

Mr. Young is director of the Northeastern University Center for Health Policy and Healthcare Research and professor of Strategic Management and Healthcare Systems at the D'Amore-McKim School of Business and the Bouvé College of Health Sciences, Northeastern University. Previously, he was professor and chair of the Department of Health Policy and Management, Boston University School of Public Health, senior associate with the Lewin Group, and also served as a health care attorney and analyst within the U.S. government. Mr. Young received a Juris Doctorate and a Ph.D. in Management from the State University of New York.

GOVERNMENT ENTITIES: FEDERAL, STATE AND LOCAL GOVERNMENTS

David P. Augustine, San Francisco, CA
Mr. Augustine is currently serving as Tax Collector in the Office of Treasurer and Tax Collector for the City and County of San Francisco. Augustine oversees 125 employees encompassing four operating sections: Business Tax, Property Tax, Legal and the Bureau of Delinquent Revenue. He has more than 12 years of professional experience, including legal experience in the municipal finance/bond arena, and is an active member of the Government Finance Officers Association and California Association of Treasurers and Tax Collectors. His office has received several awards for developing new business practices. Augustine received his J.D. from Stanford University Law School in 2002, B.A. from Swarthmore College, and a certificate from the Harvard University Kennedy School of Government - Executive Education.

Dean J. Conder, Denver, CO
Mr. Conder is the Deputy State Social Security Administrator for the State of Colorado and has more than 14 years of experience working with state and local governments on FICA tax compliance matters and related training. He is a member of the National Conference of State Social Security Administrators and serves as its training and succession planning chairperson. He co-authored an article on "Common Errors in State and Local Government FICA and Public Retirement System Compliance," which was published in the Government Finance Review (GFOA) in August 2009. He has also served as a state level board member for the state's Section 457 retirement plan. Conder previously served on the IRS Taxpayer Advocacy Panel. He is a past president of the National Association of State Social Security Administrators. Conder holds a M.S. degree from the University of Denver College of Law.

Vandee V. DeVore, Jefferson City, MO
Ms. DeVore is the Deputy State Social Security Administrator for the State of Missouri and has more than 25 years of government experience, including experience as an accountant, auditor, payroll manager and Assistant Director, Division of Accounting. As the Assistant Director, Division of Accounting, Ms. DeVore oversaw and managed statewide payroll, including tax withholding, reporting and reconciliations, Social Security Administration and statewide employee benefit budget preparation. As the Deputy State Social Security Administrator, Ms. DeVore acts for the state with respect to its responsibilities for maintaining and administering the provisions of the state's Section 218 agreement/modifications and the proper application of Social Security and Medicare coverage. She is an active member of the Association of Government Accountants, having served in several roles in the local Chapter and the national organization. She currently serves as the President of the National Conference of State

Social Security Administrators. Ms. DeVore is also an adjunct instructor of managerial, governmental and non-profit accounting at Columbia College in Missouri. She holds a CGFM and has a B.A. degree in accounting from William Woods College in Missouri and a M.B.A. from Columbia College.

GOVERNMENT ENTITIES: INDIAN TRIBAL GOVERNMENTS

Tino Batt, Fort Hall, ID
Mr. Batt is a member of the Fort Hall Business Council, the governing body of the Shoshone-Bannock Tribes of Idaho. He has served in the appointed position of Tribal Treasurer since 2009. In this position, Mr. Batt is involved in monitoring the financial management and accounting practices of all tribal entities operating within the tribal government structure. Mr. Batt also serves on the Board of Directors for the Native American Bank and has served since 2005 as a volunteer with the AARP Foundation Tax Aide program and Volunteer Income Tax Assistance (VITA) program. In addition, he has represents the Shoshone-Bannock Tribes at the Tribal Interior Budget Council (TIBC), Administration for Children and Families Tribal Advisory Committee (ACF TAC), as well the Alternate for the Northwest Region for the Department Health and Human Services Secretary Tribal Advisory Committee (STAC). Mr. Batt has a Bachelor of Science degree in Human Resource/Corporate Training and Development from Idaho State University.

Stefani A. Dalrymple, Fairbanks, AK
Ms. Dalrymple is a CPA and owner of Yukon Accounting & Consulting in Fairbanks. For the past 10 years, she has worked primarily with the Native Alaskan villages and organizations in rural Alaska to ensure compliance with federal and state tax and accounting requirements. She has also served directly as a tribal government employee in the capacities of both Fiscal Officer and Payroll Manager. Ms. Dalrymple earned her Bachelor of Science degree in Accounting at the University of Alaska Fairbanks.

Diane M. Gange, Sequim, WA
Ms. Gange is CFO of Jamestown S'Klallam Tribe and is responsible for fiscal oversight of the Tribe's operations and all of its enterprises. She is responsible for the analysis and interpretation of financial information pertaining to the Tribe and its operation's performance. She makes recommendations concerning business policy, resource allocation, and business operations to improve financial performance. She is also responsible for analyzing and determining tax strategies relating to tribal business programs, advising Tribal Council on tax consequences of programs affecting its citizens, and developing policies and plans for company relations with outside firms. She is a member of the State of Washington Department of Revenue Tribal Tax Advisory Committee working to find solutions to jurisdictional and tribal tax issues in the state. She has conducted training in accounting principles and governmental accounting. Ms. Gange received a Bachelor of Science in Accounting from Central Washington University, Ellensburg, WA, and an Associate of Arts in Accounting at Peninsula College, Port Angeles, WA.

GOVERNMENT ENTITIES: TAX EXEMPT BONDS

Katherine A. Newell, Princeton, NJ
Ms. Newell is Director of Risk Management and Ethics Liaison Officer at the New Jersey Educational Facilities Authority (NJEFA) responsible for developing and implementing post-issuance tax compliance policies and procedures. As a Government Finance Officers Association member, she worked with the National Association of Bond Lawyers on the GFOA-NABL Post Issuance Compliance Checklist and is a member of the GFOA's Debt Committee. Prior to joining NJEFA, she engaged in the private practice of law, specializing in financing for governmental entities and conduit borrowers. Ms. Newell received her LL.M in Taxation from Georgetown University School of Law, Washington, D.C., a Juris Doctorate from Villanova University School of Law, Villanova, Pa.; and a Bachelor of Arts in Mathematics from Temple University, Philadelphia, PA.

Floyd Newton III, Atlanta, GA
Mr. Newton is a partner at King & Spalding in Atlanta in the public finance practice. He has more than 30 years of broad experience with tax-exempt bonds. Newton is an active member of the ABA Tax Section 103 Committee and the National Association of Bond Lawyers. He was President of NABL in 1998-1999 and served on NABL's Board of Directors from 1994-2000. Newton received a Bachelor's degree, magna cum laude, from Princeton University, and received a Juris Doctorate, magna cum laude, from the University of Georgia Law School.

Lorraine Tyson, Chicago, IL
Ms. Tyson is a tax partner in Pugh, Jones & Johnson, P.C.'s Public Finance Practice Group and advises clients on federal tax and securities law issues that arise in public finance and privatization transactions. She also serves as tax controversy counsel to issuers or other participants on bond deals audited by the IRS. Ms. Tyson is a member of the Tax Committee of the National Association of Bond Lawyers (NABL). She served as Chair of NABL's 2015 Tax and Securities Law Institute. Ms. Tyson received an LLM in Taxation from Northwestern University School of Law, a Juris Doctorate from the University of Illinois College of Law, and a Bachelor of Arts from Northwestern University. She is a member of the Governors State University Board of Trustees and is also a member of Women in Public Finance's Board of Directors.

GENERAL REPORT
OF THE ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES (ACT)

This General Report is presented in connection with the 14th annual public meeting of the IRS Advisory Committee on Tax Exempt and Governmental Entities (ACT).

As described in the ACT's Charter, the purpose of the ACT is to provide an organized public forum for the discussion between IRS officials and representatives of the five areas within the jurisdiction of the Tax Exempt and Governmental Entities Division (TEGE): Employee Plans (EO); Exempt Organizations (EO); Federal State and Local Governments (FSLG); Indian Tribal Governments (ITG); and Tax Exempt Bonds (TEB). This year, of the twenty (20) members of the ACT, six (6) represent EP, five (5) represent EO, three (3) represent FSLG, three (3) represent ITG and three (3) represent (TEB).

Under the Charter, the ACT reports to the Commissioner, TEGE Division and the ACT members work respectively with the Directors of EP, EO, FSLG, ITG and TEB to identify and research the issues that will be addressed and reported to the Commissioner at the public meeting scheduled for June 17, 2015. This year the following reports will be presented:

- **Employee Plans:** Analysis and Recommendations Regarding 403 (b) Plans
- **Exempt Organizations:** The Redesigned Form 990- Recommendations for Improving its Effectiveness as a Reporting Tool and Source of Data for the Exempt Organization Community
- **Federal, State and Local Governments:** FSLG Education and Outreach- Review and Recommendations
- **Indian Tribal Governments:** Recommendations for Outreach and Training- A revision to the Indian Tax Desk Guide
- **Tax Exempt Bonds:** Doing More With Less – Balancing Resources and Needs

In the face of significant budget and staffing reductions, this year's recommendations address current issues facing EP, EO, FSLG, ITG and TEB with a view to maximizing internal and external knowledge management, outreach and training while prioritizing and balancing resources. The ACT hopes that these recommendations will prove helpful to TEGE personnel and the communities with which they interact.

Acknowledgements and Recognition

ACT members are appointed for a two (2) year term which may be extended by an additional year. This year:

- Donna M. Mueller, CEO of the Iowa Public Employees Pension System (EP)
- David Mustone, Partner, Hunton & Williams LLP (EP)
- Gary J. Young, Director of the Northeastern University Center for Health Policy and Healthcare Research (EO)
- Diane M. Gange, CFO of Jamestown S'Klallam Tribe (ITG)
- Lorraine M. Tyson, Partner, Pugh, Jones & Johnson, P.C. (TEB)

and (TEB) will end our third year as members of the ACT and will be succeeded by new appointees with experience in the respective areas that we have represented. I believe I speak for all members of the ACT that it has been a pleasure and a privilege to know and work with them.

The ACT thanks Commissioner John Koskinen, TEGE's Leadership, Commissioner Sunita Lough, Deputy Commissioner Donna Hansberry and Deputy Assistant Commissioner, Shared Services Nan Downing, the TEGE Division Directors Rob Choi, Tammy Ripperda, Christie Jacobs, Paul Marmolejo and Rebecca Harrigal and all of the TEGE staff for the support and assistance you've provided to the ACT throughout the year. Special thanks to Mark O'Donnell, the Designated Federal Officer to the ACT and TEGE's Communications & Liaison Director and his team, Melanie Partner, Tanya Barbosa, Nicole Swire and Cynthia Phillips-Grady (Retired) for handling the logistics for our meetings, conference calls and technology needs for surveys and other information gathering activities. Special thanks as well to all those who participated in the surveys, focus groups and other information gathering critical to the analysis and recommendations made in the reports.

For me, serving on the ACT has been a rewarding personal and professional experience. I am fortunate to have had the opportunity to work with and learn from all of TEGE's leadership and the other ACT members who have served during the past three years. Thank you to everyone and congratulations to Alison Cohen, the incoming chair. I hope that our input is helpful to the Service and to the constituent groups we serve.

Katherine A. Newell
Chair, June 2014 to 2015
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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Employee Plans:
Analysis and Recommendations
Regarding 403(b) Plans

Alison J. Cohen, Esq.

Donna Mueller, Esq.

David Mustone, Esq.

Chris Shankle, CPA, CGMA

Stuart A. Sirkin, Esq.

Matthew I. Whitehorn. Esq.

June 17, 2015

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I. EXECUTIVE SUMMARY

The Employee Plans Subcommittee of the ACT (EP Subcommittee) chose as its 2014-2015 project a reexamination of the current state of the 403(b) community seven years after the issuance of the 403(b) final regulations (403(b) Final Regulations).[1] Specifically, the EP Subcommittee endeavored to identify the key issues that are plaguing the ability of the 403(b) plan sponsor to remain in compliance with requirements of the Internal Revenue Code (Code), so that the Internal Revenue Service (Service) can better focus its limited resources to do the greatest amount of good.

Recommendations from the EP Subcommittee, documented in prior ACT Reports, relating to 403(b) plans paved the way for the current pre-approved 403(b) document program and enhancements to the Employee Plans Compliance Resolution System (EPCRS). However, the EP Subcommittee felt that there remained a need to identify the problems that exist today as plans transition to the pre-approved document program and the Service faces tremendous budgetary constraints.

Section IV of the EP Subcommittee Report (EP Report) covers four specific areas that the EP Subcommittee believes require additional guidance and/or support pieces from the Service. First, universal availability is an operational issue that has long been identified by both by Employee Plans (EP) and the 403(b) community as a particularly challenging requirement. Second, “orphan” 403(b) contracts that were either “frozen” before 2009 or cover former employees with contracts issued before 2009 remains a troubling issue. Third, the requirements and challenges that face 403(b) plan sponsors that need to terminate their plans still needs to be addressed. Finally, improvements to EPCRS are necessary to better address the document and operational needs of the 403(b) community.

Included in the EP Report, under Appendix A, are the results of the survey that the EP Subcommittee distributed to the 403(b) community, including 403(b) plan sponsors and vendors.

The EP Subcommittee project would not have been possible without the support of, and encouragement from EP Director Robert Choi and his staff. Their valuable time and experience were instrumental to the EP Subcommittee’s understanding of the complexities of this topic and the EP Subcommittee’s ability to present its recommendations.

[1] Treas. Reg. §1.403(b)-3(b)(3), -11(a) (2007).

II. INTRODUCTION

The EP Subcommittee decided to review the current status of the 403(b) realm for its section of the 2015 ACT Report for a number of important reasons. The release of the 403(b) Final Regulations in 2007 was the kick-off for a number of critical "firsts" for the 403(b) community. 403(b) plan sponsors had to have their first written plan document in place by the end of 2009. The 403(b) service providers were permitted to submit their first preapproved document for approval by the Service by the end of April 30, 2015. Plans with document errors were first permitted to file through the EPCRS in 2013 with the release of Revenue Procedure (Rev. Proc.) 2013-12. As with most things in life, when something is done for the first time, there are likely errors and a substantial learning curve to be overcome.

The Service has been experiencing, and addressing, some of the challenges that it has faced with 403(b) plans. The impact of some of these operational, procedural and legal challenges has been felt in all areas of EP. For example, EP auditors have had to learn about the nuances of 403(b) plans and how they differ from qualified plans. Additionally, various Employee Plans Compliance Unit (EPCU) research projects regarding 403(b) plans have been initiated.

The EP Subcommittee is also very sensitive to the ongoing loss of resources available to EP, and the Service, in general, which restricted its ability to offer more robust and timely guidance for the 403(b) community. It is the EP Subcommittee's goal to respectfully highlight certain key areas that are ripe with opportunity to provide meaningful value to the 403(b) plan sponsors given the current resourcing issues.

Overarching many of the recommendations in this EP Report is the obstacle that impedes many 403(b) plan sponsors from remaining in compliance with the Code. There exists a conflict between the duty of the 403(b) plan sponsor to ensure that the plan stays in compliance with the Code and its competing interest in avoiding significant involvement with the plan, such that the actions of the 403(b) plan sponsor would possibly trigger ERISA status for it as defined under ERISA. This conflict creates a detached attitude by the party that is in the best position to ensure compliance regarding day-to-day activities, and places an unhealthy level of dependence on service providers who have at least an equal interest in avoiding the "fiduciary" label.

This EP Subcommittee section of the ACT Report will provide a brief history of 403(b) plans and their evolution, highlighting the specific impact to the 403(b) plan requirements, correction opportunities, and education and outreach programs that have

been offered. The specific recommendations which the EP Subcommittee present herein include:

- **Universal availability** – A review of the universal availability rules and history provides a backdrop for a discussion of the key areas that need "soft" guidance and/or expanded outreach programs.
- **"Orphan" 403(b) contracts** – Unlike the majority of qualified plans, 403(b) participants held individual contracts which, prior to the issuance of the 403(b) Final Regulations, may have been placed with any number of vendors. If these participants severed their employment prior to 2009 and no additional contributions were made to the plan account after that time, based on guidance from the Service, a plan sponsor need not list these contracts in its plan. The impact on the rest of the 403(b) plan should these "orphan" plans fail to comply with the Code requires clarification.
- **Minimizing contract leakage** –The previously mentioned lack of ownership taken by 403(b) plan sponsors seeking to avoid the "fiduciary" moniker has led to a challenge for vendors when faced with a withdrawal request from a participant. Providing guidance to vendors that would allow them to take certain actions would help to preserve these valuable retirement assets.
- **403(b) plan terminations** – Given the many practical problems that are a by-product of the nature of the 403(b) structure, additional guidance is needed to address the more technical issues. However, there are opportunities for the Service to supply assistance through expansion of the online tools that are already available that cover termination issues.
- **EPCRS improvements** – In light of the many firsts experienced by the 403(b) community in the past decade, including the upcoming restatement onto new pre-approved documents, there is a need to update EPCRS to encourage use of the program and compliance with the Code. Possible improvements discussed include allowing certain loan failures to be self-corrected, broadening the use of the Department of Labor (DOL) online calculator, creating additional application schedules for 403(b) issues and discounted fees.

III. HISTORY

The history of 403(b) retirement vehicles shows a slow evolution from a very limited type of vehicle offered by a limited class of employers to an expanded choice of vehicles offered by a broader range of employers. Today one could say that the 403(b) offerings and requirements closely mirror that of 401(k) retirement vehicles. The culmination of the growing alignment of the regulatory environment of the two retirement vehicles occurred with the adoption of the 403(b) Final Regulations in 2007.[2] Of particular importance in the 403(b) Final Regulations was the requirement that all plan sponsors, and not just sponsors under plans covered by the Employee Retirement Income Security Act of 1974, as amended (ERISA), maintain a plan document detailing primary provisions of the plan and especially detailing elements required by the Code and regulations.

While the regulatory expectations are now similar, the administration of 403(b) arrangements does not yet mirror that of 401(k) arrangements. The difference in administration is in part due to the lengthier history of 403(b) arrangements, the limited types of retirement vehicles available for much of its history, the classes of employers authorized under Section 403(b) and the limited involvement of the employer/plan sponsor in the arrangements. What follows in this history section are the highlights of major legal and regulatory changes to 403(b) arrangements, previous ACT recommendations and the activities of the Service to bring 403(b) arrangements into compliance.[3]

A. Allowable retirement vehicles

The Revenue Act of 1942 first permitted certain tax-exempt organizations to purchase tax sheltered annuities (TSA) for their employees. In 1958, legislation codified the requirements in Section 403(b) of the Code addressing several issues with TSA arrangements and clarified that only Code Section 501(c)(3) organizations could offer its employees a TSA arrangement.

It was not until ERISA's enactment in1974 that the 403(b) funding vehicles were expanded beyond the TSA realm. Title II of ERISA expanded the funding vehicles to include custodial accounts or mutual funds.

[2] Treas. Reg. §1.403(b)-3(b)(3),-11(a) (2007).
[3] See the ACT Report, "Document Compliance Program for 403(b) Arrangement, dated June 7, 2006 for a detailed chronological history of 403(b) arrangements.

B. Authorized employers

In 1961, the pool of authorized employers was expanded from 501(c)(3) organizations to include public educational entities. This remains the case today, with small and large tax-exempt 501(c)(3) organizations (including non-profit hospitals), church plans, K-12 public schools, and higher education colleges and universities offering 403(b) arrangements.[4]

While ERISA did not change the types of employers eligible to offer 403(b) plans, it did exempt 403(b) plans sponsored by certain eligible employers from compliance with Title I of ERISA (which imposed fiduciary and reporting duties on plan sponsors). In accordance with ERISA's general exemption for government and non-elective church plans, ERISA exempts 403(b) plans sponsored by public educational entities and non-electing church plans. By regulation, The Department of Labor (DOL) treated charitable organizations with limited employer involvement in the 403(b) arrangement as not sponsoring an employer-provided plan and thus not subject to Title I of ERISA.[5] Employer involvement is considered limited in arrangements where employee participation is voluntary, the employer allows 403(b) product vendors to publicize their products, salary reduction contributions are withheld and forwarded to the applicable product agent, and the employer makes no contributions.[6]

Current estimates indicate that non-ERISA plans comprise 75% of the 403(b) plan market.[7] Because governmental plans, church plans and other non-ERISA plans are not required to make annual Form 5500 filings with the DOL or the Service, the number, nature, and coverage of 403(b) plans are not as well documented as the statistics for 401(k) plans.

Essentially, the exemption from ERISA of governmental entities, church plans, and charitable organizations with limited employer involvement in the administration of the plan, reinforced the view by employers that they were merely the conduit for contributions to products selected by the employees. The only governing document was the individual or group TSA contract or custodial account contract (new in 1974), neither of which were viewed as the responsibility of the employer. Many non-ERISA covered employers deal with

[4] See *PLANSPONSOR Magazine,* October 2014*,* pages 64-65 for a sample breakdown of type of clients by 26 providers responding to the magazine's provider questionnaire. All data is as of December 21, 2013.
[5] DOL Reg. §2510.3-2(f).
[6] See EBSA FAB 2007-2 , which explains how DOL treats the impact of the 403(b) Final Regulations on when an employer is considered to be sponsoring a 403(b) plan.
[7] *PLANSPONSOR Magazine*, October 2014, at p. 62.

multiple vendors that have been selected by the individual employees. Thus, the employers' views were that they had multiple governing documents. Pulling these together under one umbrella-type employer-sponsored plan document is a continuing challenge for many non-ERISA covered employers.

Employers who dealt with multiple vendors also faced the issues of dealing with pre-2009 contracts. With respect to some of the contracts, the vendor no longer received any contributions; with respect to others, the employee was no longer employed by the employer. These contracts are commonly referred to as "orphan contracts." Guidance as to how to deal with orphan contracts was provided in Rev. Proc. 2007-71.[8]

C. Evolution of 403(b) plan requirements

1. Annual contribution limits

There were no limits on the employer contributions made under TSA arrangements established in 1942. However, in 1958, Code Section 403(b) introduced the exclusion allowance, which limited the maximum annual amount that could be excluded from taxable income through a TSA. It also clarified that the TSA had to be purchased by the employer for the employee; direct purchase by the employee was not permitted.

With the enactment of Title II of ERISA, the maximum contribution limits of Code Section 415 were imposed on all 403(b) plans, in addition to the exclusion allowance limits. Special 403(b) catch-up provisions also allowed employees nearing retirement to make greater contributions if they had not contributed much in their earlier years of employment with particular employers.

The contribution limits and special catch-up provisions were modified by the Tax Reform Act of 1986 (TRA '86). More significant reform was included in the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) in 2001. EGTRRA repealed the exclusion allowance and replaced the previous special catch-up provisions with a new provision. EGTRRA's reforms made the 403(b) contribution limits similar to those that apply to 401(k) plans.

[8] "Orphan" contracts are discussed in more detail later in this report.

2. Universal availability

Prior to TRA '86, an employer offering a 403(b) arrangement could limit its application to select individuals or select classes of employees. TRA '86 imposed a universal availability requirement on any salary reduction agreements.[9] Simply stated, if a plan provides any salary reduction option, it must be made available to all employees willing to contribute at least $200 per year.

Although it has been nearly thirty years since the enactment of TRA '86, universal availability is still a common area of misunderstanding and error in application. There is some evidence that this may be due to the nature of the unusual employment arrangements used by those eligible to sponsor 403(b) plans. These employers often employ less than full-time employees whose hours are hard to measure (e.g., college lecturers who teach one course) or employees who receive pay on an irregular basis (e.g., substitute teachers). In an effort to understand the compliance issues regarding universal availability, the Employee Plans Compliance Unit (EPCU) of the Service has been studying this issue in K-12 schools and in organizations of higher education. It is anticipated that these studies will lead to the issuance of further guidance on universal availability.

3. Written 403(b) plan document

As noted earlier, public educational entities, churches and tax-exempt entities that were not considered to have an employer-sponsored plan under Title I of ERISA faced no requirement to have a written plan document detailing plan requirements prior to the 403(b) Final Regulations. Many employers looked to the vendors as the party responsible for record keeping and documentation. Administering a 403(b) arrangement took a dramatic turn with the issuance of the 403(b) Final Regulations requiring all employers to have a written plan document in place by December 31, 2009.[10] The employer was now acknowledged as the sponsor of the 403(b) plan or plans and expected to administer the plan(s) in compliance with a written plan

[9] Code §403(b)(12)(A)(ii).
[10] Treas. Reg. §1.403(b)-3(b)(3) & -11(a), effective January 1, 2009, later extended to December 31, 2009, by Notice 2009-3.

document that incorporated provisions in compliance with Code Section 403(b).[11]

While requiring a written plan document for an employer's 403(b) arrangement, the Service has never made a determination letter program available to the employers to assure them that their documents were in compliance with the rules. Prior to the implementation of the 403(b) written plan documentation requirement, the 2006 ACT Report recommended a limited determination letter process for individually designed 403(b) plans.[12] An approval letter program for individually designed 403(b) plans was again discussed and encouraged by the ACT in its 2010 report.[13] However, to date, there is no determination letter or approval letter program available for individually designed 403(b) plans. Because of resource constraints, the Service has publicly stated that there is no current intention to implement such a program.

Recognizing that a number of non-ERISA employers offered salary reduction-only plans, the 2006 ACT Report recommended that the IRS create a simple salary reduction-only model document. In 2007, the IRS provided such model plan language for use by public schools. The model plan language could be used to either adopt a written plan to meet the new written plan document requirements of Section 403(b) or to amend an existing written plan document to meet the requirements.[14]

The introduction of a pre-approved plan program for 403(b) plans was also recommended as part of the 2006 ACT Report.[15] The intent to establish a procedure for pre-approval of 403(b) prototype and volume submitter plans was announced by the Service in 2009.[16] Document compliance may be obtained through adoption of a pre-approved 403(b) prototype or a volume submitter plan document. The initial cycle for submission of documents for prototype plans and volume submitter plans ended April 30, 2015.[17] After the initial submission by document providers to the Service, the Service must

[11] Plan document must include eligibility criteria, contribution limits, description of benefits and distribution requirements. If the plan sponsor allows certain optional provisions such as loans and hardship distributions, the plan document must include such provisions.
[12] ACT Report, June 7, 2006, at page 26, suggesting that the determination be limited to the terms of the plan and not include non-discrimination determinations.
[13] ACT Report, June 9, 2010, at pages 46-48, also recommended that the approval letter cover underlying annuity contracts and custodial agreements.
[14] Rev. Proc. 2007-71.
[15] ACT Report, June 7, 2006, at pages 23-26.
[16] 2009-18 I.R.B. 916.
[17] Rev. Proc. 2013-22, as modified by Rev. Proc. 2014-28.

approve the documents and then an open window will be provided for employer's to adopt the pre-approved plan. Thus, the adoption process is likely to continue into 2017 and 2018.

Without a determination letter for an individually designed plan or the availability of a pre-approved plan program, some comfort from the Service could be obtained in the past by applying for a private letter ruling. A Service-issued private letter ruling is, and was, available to 403(b) plans, even prior to the requirement of a written plan document. However, private letter rulings are expensive and generally directed at specific issues within a plan. Therefore, a private letter ruling does not provide the assurance of qualification as to the form of the plan that a determination or pre-approved letter provides.

D. Employee Plans Compliance Resolution System (EPCRS)

Prior to the adoption of the 403(b) Final Regulations in 2007, sponsors of 403(b) arrangements were still expected to be in operational compliance with applicable program regulations. ERISA-covered plan sponsors were also expected to have a plan document compliant with the regulations, and operate pursuant to the plan document. Correction of 403(b) plan non-compliance with either operational or document failures could be addressed through various correction programs.[18]

Rev. Proc. 98-22 established EPCRS as an umbrella program for the various correction programs available to retirement plans, including 403(b) plans. The primary correction avenues under EPCRS include the self-correction program (SCP), the voluntary compliance program (VCP) and correction on audit (Audit Cap).[19]

There were several features added to EPCRS in Rev. Proc. 2013-12 that expanded EPCRS's application to 403(b) plans. First, the acknowledgment that a 403(b) plan document failure could be corrected under EPCRS in the same manner as other qualified plan errors. Second, the failure to adopt a written plan document in accordance with Notice 2009-3 could be corrected by making a VCP

[18] Self-Correction of operational defects of qualified retirement plans was extended to 403(b) plans in 1996. Voluntary Compliance Resolution for qualified retirement plans, including 403(b) plans, began with Rev. Proc. 92-89 when EPCRS was first introduced. An additional Tax Sheltered Annuity Voluntary Compliance Program was established in Rev. Proc. 95-24.

[19] Initially EPCRS retained different VCP avenues depending upon the type of retirement plan. Eventually, VCP named distinctions were eliminated. Rev. Proc. 2003-44.

submission at a reduced fee of 50% of the applicable compliance fee if the VCP submission was made no later than December 31, 2013.

E. Service education and outreach programs

Over the years, the Service has initiated a variety of programs to educate plan sponsors and practitioners on compliance issues with 403(b) plans. This has included participating in benefit conferences, producing webinars that are issue specific, and hosting resource guides and frequently asked questions published on the Service website.

The web resource most commented on in the EP Subcommittee's interviews and survey was the 403(b) Plan Fix-It Guide (403(b) Fix-It Guide). This Guide is an easy to read list of common mistakes, directions as to gauging whether the mistake is relevant to a particular plan and information on how to fix and/or avoid the mistake. While presented in a summary two-page compilation, the 403(b) Fix-It Guide includes links to in-depth discussions and links to further resources. The 403(b) Fix-It Guide is a useful tool for practitioners; it is also a useful aide for plan sponsors. The challenge, however, appears to be to get it into the hands of the population of disengaged plan sponsors that are seemingly prevalent in the 403(b) realm.

IV. DUE DILIGENCE

The EP Subcommittee conducted interviews with 403(b) service providers, practitioners, plan sponsors and document providers. The enthusiasm that was shown for this topic, and the generosity with which we were given their precious time, is very much appreciated. We thank everyone for their valuable insights and comments.

The EP Subcommittee used the information gathered through the interviews to develop a survey that was made available to a broader audience through numerous channels. It was our goal to reach not only a variety of practitioners and service providers, but to also reach 403(b) plan sponsors. The results from this survey are summarized in Appendix A.

Finally, the EP Subcommittee spent a great deal of time with staff members of EP. EP Director Rob Choi and his staff, including senior members of the EP leadership team, were generously made available to us so that the EP Subcommittee was able to have informative and beneficial in-person, and telephonic, discussions and interviews. The EP Subcommittee was provided with statistical information regarding 403(b) plan filings made through EPCRS Voluntary Compliance Program, anecdotal information gathered from audits of 403(b) plans and detailed results from the EPCU projects on universal availability in K-12 schools and higher education institutions.

Our research yielded a broad array of recommendations that focus on the deepest pain points experienced by the 403(b) plan community. Our recommendations provide EP with key opportunities to provide relief and increased compliance with the Code. These recommendations include improvements to EPCRS, universal availability educational/outreach needs, and guidance on “orphan” 403(b) contracts and 403(b) plan terminations.

V. RECOMMENDATIONS

A. Universal availability rule issues

1. Background

The Code contains special nondiscrimination rules pertaining to employee salary reduction contributions (whether pre-tax or designated Roth contributions) under 403(b) plans. Thus, 403(b) plans must generally permit all employees with the opportunity to make such elective deferrals, with certain limited exceptions.[20] This special eligibility requirement is commonly referred to as the "universal availability" requirement, or more commonly, the universal availability rule. In application, it has proven to be a source of confusion and, frequently, consternation for 403(b) plan sponsors who do not understand how to apply it or are not even aware of its existence. Despite the apparent lack of clarity about how this rule applies, failure to comply may hold draconian consequences, that is, disqualification of the plan and all contracts under the plan resulting in taxable income to employees.[21]

In certain segments of the non-profit and governmental community, uncertainty continues to reign about the application of the universal availability rule which in turn, has resulted in significant levels of noncompliance. Service representatives have publicly stated that, when auditing 403(b) plans, the Service's focus is on universal availability rule compliance. The Service has found that institutions of higher learning have improperly excluded adjunct and visiting faculty members from making salary reduction contributions while public schools have similarly improperly excluded bus drivers, janitors and cafeteria workers. Small non-profit employers have likewise wrongfully excluded part-time employees and interns.

2. Exemptions from application of the universal availability rule - excluded employees

Under the universal availability rule, the opportunity to make elective deferrals must generally be extended to all employees (subject to the limited exceptions noted below) once any employee is offered such an election. The employees to which the employer must make salary deferrals available under

[20] Code §410(b)(12).
[21] Treas. Reg. §1.403(b)-3.

the universal availability rule include those who have not yet satisfied the plan's minimum age and/or service threshold requirement for eligibility to receive employer matching and/or nonelective contributions.

The statutory and regulatory categories of employees excludable for purposes of applying the universal availability rule are:

- Any employee not willing to make salary reduction contributions of more than $200;[22]
- Students providing services described in Code Section 3121(b)(10) (i.e., college work-study students);[23]
- Non-resident aliens with no U.S.-source income;[24]
- Employees eligible to make elective salary contributions to another 403(b), governmental 457(b) or 401(k) plan of his/her employer;[25] and
- Employees who "normally" work less than 20 hours per week (or any lower number stated in the plan document).[26]

In the case of a 403(b) plan covering employees of multiple employers, the universal availability rule applies separately to each distinct common law tax-exempt entity.[27] Because the universal availability rule applies on an entity-by-entity basis and a for-profit entity cannot sponsor a 403(b) plan, employees of a for-profit subsidiary in a controlled group that includes a non-profit entity member are not taken into account for purposes of the universal availability rule. In the case of a governmental 403(b) plan covering employees of more than one state entity, the universal availability rules applies on a separate basis to each entity not using a common payroll.[28] If a tax-exempt employer has historically treated a geographically distinct

[22] Code §403(b)(12)(A)(ii); Treas. Reg. §1.403(b)-5(3)(i).
[23] Code §403(b)(12)(ii) flush text; Treas. Reg. §1.403(b)-5(b)(4)(ii)(B).
[24] Code §403(b)(12)(ii) flush text; Treas. Reg. §403(b)-5(b)(4)(ii)(C).
[25] Code §403(b)(12)(ii) flush text; Treas. Reg. §1.403(b)-5(b)(4)(ii)(A) & (B).
[26] Code §403(b)(12)(A)(ii) flush text; Treas. Reg. §1.403(b)-5(b)(4)(ii)(E). Under the IRS Notice 89-23, the universal availability rule also did not apply to employees making a one-time election to participate in a governmental plan sponsor's plan in lieu of its 403(b) plan; collectively bargained employees; certain visiting professors at public universities; and employees of a religious order who took a vow of poverty. However, employees who take a vow of poverty can continue to be excluded if they are considered non-employees under Service guidance relating to wage withholding; visiting professors can similarly be excluded if they continue to be paid by the "home" university while temporarily teaching at another institution and they make elective deferrals to their "home" university's 403(b) plan. Notice 89-23 was superseded by the 403(b) Final Regulations, although transitional relief allowed some of these work classification administrative exceptions (collectively bargained and one-time government plan elector employees) to continue to be excluded under the universal availability rule for a limited period of time.
[27] Treas. Reg. §1.403(b)-5(b)(3)(i).
[28] Id.

operation for employee benefit purposes separately on a day-to-day basis, it may do so under the universal availability rule provided the entity is not located within the same standard metropolitan statistical area.[29]

The Conference Committee Report to TRA '86 regarding the universal availability rule follows the House Committee Report which states, in pertinent part,

> Under the bill, a tax-sheltered annuity program that permits elective deferrals will be considered discriminatory with respect to those deferrals unless the opportunity to make elective deferrals is made available to all employees of the annuity sponsoring the tax-sheltered annuity program… In applying the special test for deferrals, no employees of the entity sponsoring the tax-sheltered annuity program (other than nonresident aliens with no U.S.-source earned income) may be excluded from consideration. For example, the qualified plan rules permitting the exclusion of certain employees based upon age and service and coverage under collective bargaining agreements do not apply.

The Conference Committee then noted:

> The conference agreement follows the House bill, except that in applying the nondiscriminatory coverage rule applicable to elective deferrals under a tax-sheltered annuity program, the employer is to exclude from consideration students who normally work fewer than 20 hours per week, as discussed above.[30]

The Technical and Miscellaneous Revenue Act of 1988 (TAMRA) added a reference to "employees who normally work less than 20 hours per week" to Code Section 403(b)(12) provisions that previously excluded all work-study students from application of the universal availability rule.[31]

3. Operation of the less than 20 hours per week provision

Under the 403(b) Final Regulations, the less than 20 hours per week rule appears to be intended to operate as follows: an employee is treated as

[29] Treas. Reg. §1.403(b)-5(b)(3)(ii).
[30] Conference Committee Report on TRA '86 §1120.
[31] Conference Committee Report on TAMRA §6052.

"normally" working fewer than 20 hours per week if and only if: (1) the employer reasonably expects the employee to have fewer than 1,000 hours of service during the 12-month period beginning on the employment commencement date; and (2) for each subsequent 12-month period ending after the first anniversary date of hire, the subject employee actually worked fewer than 1,000 hours during the previous one-year period (the "look-back period").[32] The Service's interpretation of the statutory provision is most clearly set forth in the Listings of Required Modifications (LRMs) issued on March 10, 2015. In pertinent part, the LRMs state:

> An Employee normally works fewer than 20 hours per week, if, for the 12-month period beginning on the date the Employee's employment commenced, the Employer reasonably expects the Employee to work fewer than 1,000 hours of service (as defined under section 410(b)(3)(C) of the Internal Revenue Code) in such period, and, for each Plan Year ending after the close of that 12-month period, the Employee has worked fewer than 1,000 hours of service in the preceding 12-month period. Under this provision, an Employee who works 1,000 or more hours of service in the 12-month period beginning on the date the Employee's employment commenced or in a Plan Year ending after the close of that 12-month period shall then be eligible to participate in the Plan. (Emphasis added).

Most prototype 403(b) plan documents allow the plan sponsor the choice of using the anniversary date of hire or the plan year as the measuring date for computing the period during which the 1,000 hours is measured subsequent to the first anniversary of employment year. If the plan sponsor reasonably expected the employee to work less than 1,000 hours during the look-back period, but, in fact, the employee during such look-back period worked in excess of that amount, then he or she must be eligible to participate in the year immediately following the close of the "look back" period and for all subsequent periods.

The 403(b) Final Regulations on the universal availability rule state that the exclusion of work-study students and employees who work less than 20 hours per week is subject to the conditions applicable under Code Section 410(b)(4) (by cross-referencing Code Section 410(b)(4)). Code Section 410(b)(4) relates to the permitted exclusion of employees not meeting age and service

[32] Treas. Reg. §§1.403(b)-5(b)(4)(iii)(B)(1) and (2).

requirements from minimum coverage testing under Code Section 410(b) and provides for the separate testing of such employees who still participate in the subject plan. The 403(b) Final Regulations interpret the reference to Code Section 410(b)(4) in Code Section 403(b)(12) to mean than if any work-study student or employee who works less than 20 hours per week is offered the opportunity to make elective deferrals, then all work-study students and employees who work less than 20 hours per week must be provided with the same election opportunity as indicated in the above-referenced legislative history.[33] Consequently, work-study students and employees who worked less than 1,000 hours during the previous plan year or 12-month period or, if new, who are expected to work less than 1,000 hours in the current year, must nevertheless, be allowed to make elective deferrals under the universal availability rule even if only one such employee is allowed to do so (the "all or nothing" standard).

Code Section 410(b)(4)(B), which is specifically referenced in the portion of the 403(b) Final Regulations pertaining to the work-study student exclusion, provides for separate minimum coverage testing for employees who could be excluded from a plan due to the minimum age and service requirements, but whom the employer still allows to participate in the plan.[34] The inclusion of this special separate testing provision, on its face, would permit some work-study student employees to make salary reduction contributions, while others are excluded, provided that the portion of the 403(b) plan covering the members of this otherwise excluded group satisfied the minimum participation standards set forth in Code Section 410(b)(1) on a stand-alone basis (as if these individuals were participating in a separate plan).

4. Intent of the universal availability rule

The overall intent of the Service and Treasury appears to have been to minimize the number of categories of employees that are exempt from the application of the universal availability rule. From the Service's perspective, this would decrease the possibility of discrimination in availability of salary reduction contributions for lower-paid employees. The preamble to the 403(b) Final Regulations sheds some light on the interpretation of the universal availability rule and the Service and Treasury's narrow construction of the governing statute.[35] When discussing the elimination of the previous

[33] Treas. Reg. §1.403(b)-5(b)(4)(i).
[34] Treas. Reg. §1.403(b)-5(b)(4)(ii)(D).
[35] 72 FR 41128 [7/26/2007].

exemption of collectively bargained employees, certain public university visiting professors, employees making a one-time election under a governmental plan and those employees taking a vow of poverty from application of the universal availability rule, the preamble notes:

> The comments submitted in response to the request generally requested to have these exclusions continue to be allowed. However, after consideration of the comments received, the IRS and Treasury Department have concluded that these exclusions are inconsistent with the statute and, accordingly, they are not permitted under these regulations. Nonetheless, as described further in the following paragraphs, other rules may provide relief with respect to individuals who are under a vow of poverty and to certain university professors affected.[36]

5. Notice

Under the universal availability rule, plan sponsors are required to provide an "effective opportunity" to eligible employees to exercise their rights under a 403(b) plan. The Service has interpreted this to mean that at least one time per year an employee must receive a notice advising him or her of the availability of the 403(b) plan and how the employee can make, or change, the amount of a salary reduction contribution.[37] There is no effective opportunity if the availability of other benefits is conditioned on whether salary reduction contributions are made. While the 403(b) Final Regulations provide great detail on what the notice to eligible employees should state, it is likely that the amount of information actually provided in operation varies immensely from employer to employer.

6. Service research to date

The EPCU, in the past, embarked on two projects directly related to the application of the universal availability rule in two non-profit segments: the "Higher Education Institutions" project (which began in 2011) and the "K-12 Schools" project covering public schools (which began in 2006). The Service has not posted the results of either of the studies on the EPCU webpage at IRS.gov. The Service also has not yet published any reports based on the findings from these two projects. Nonetheless, the EP Subcommittee

[36] 72 FR 41128 at 41134 and 41135.
[37] Treas. Reg. §1.403(b)-5(b)(2).

understands that these projects uncovered a significant level of noncompliance in operation with the universal availability rule.

A Service representative recently noted at a joint meeting of practitioner councils and liaison groups that the Service continues to observe severe violations of the universal availability rule, particularly at the K-12 school and university levels. The EP Subcommittee believes there is a need for greater outreach to the 403(b) plan community in order to educate plan sponsors about how the universal availability rule should be applied in operation. For example, while many schools properly include certain teachers and professors, we understand that they may still wrongfully exclude janitors, bus drivers and cafeteria workers.

7. Service outreach issues

The 403(b) Fix-It Guide[38] provides a helpful overview of the rules related to operating a compliant 403(b) plan, and provides a few specific examples to help direct employers as to how to apply the universal availability rule. For instance, one example addresses the exclusion of janitors, cafeteria workers, bus drivers and union employees. It also reminds employers about the notice requirements for employees under the effective availability requirement that are part of the universal availability rule. Perhaps most importantly, the 403(b) Fix-It Guide warns employers that universal availability mistakes can be costly:

> Universal availability mistakes can be very expensive to correct, so avoiding this mistake is important. You must have a good understanding of which employees you may exclude from your organization's 403(b) plan. Many organizations assume they can exclude part-time or certain classes of employees, but that's not how it works.[39]

The 403(b) Fix-It Guide contains information that is extremely useful and many survey respondents identified it as a valuable resource. The Service should consider additional ways to expand the number of sponsors that are aware of the existence of the Guide as a tool for understanding the universal availability rule.

[38] Regularly updated (most recently on April 14, 2014).
[39] 403(b) Fix-It Guide, page 19.

8. Survey respondents' issues

While many of the universal availability rule exclusions seem rather straightforward, the less than 20 hours per week exclusion has caused substantial confusion and uncertainty, especially among the many unsophisticated and small tax-exempt employers that employ part-time and other similarly-situated employees. This confusion becomes apparent when the comments to certain survey questions are reviewed. For example, 50.52% of the respondents identified compliance with the universal availability rule as the most significant operation issue that they face. Below are paraphrased and edited comments from several respondents to two of the survey questions as examples of the responses from the 403(b) community.

The two particular questions asked: "What do you think are the main topical areas for operational issues" and "What do you consider to be the most critical issue(s) for 403(b) arrangements that require Service guidance."

Among the responses to these questions were:

- Universal availability;
- There is much confusion on how the eligibility exceptions apply to workers who don't exactly fit the permissible exception to the universal availability rule. For example, employers often exclude from participation in the plan student workers who continue to work over the summer (and thus, reach the 1,000 hours threshold);
- The application of the 20 hours per week and 1,000 hours rules and how to deal with temporary employees;
- The inability to exclude certain other generally non-benefits eligible employees, specifically part-time faculty under the plan;
- Universal availability for non-ERISA plans, especially for employees whose hours are not tracked, but usually work less than 20 hours per week (e.g., adjunct faculty); and
- The lack of detailed information with ample examples regarding excluded employees and the 20 hours per week and 1,000 hours rules with an explanation about what happens when employees exceed those hour limits.

9. Where should the Service focus its resources?

Based on the foregoing and our discussions with members of the vendor and 403(b) plan sponsor community, the EP Subcommittee believes that the Service should consider providing additional educational outreach, in more detail, on at least the following issues in order to assuage continuing plan sponsor uncertainty, confusion and ignorance about the application of the universal availability rule and resultant noncompliance:[40]

- Treatment of adjunct faculty at universities;
- Treatment of part-time, seasonal and temporary employees;
- Providing some type of relief from the tracking of hours burden for tax-exempt employers (which frequently have very limited budgets and few staff);
- The meaning of the phraseology "reasonably anticipate" in terms of the 1,000 hours threshold; and
- How the less than 20 hours per week standard is meant to apply. For example:
  - Can employees who work less than 20 hours per week, who could be tested separately under Code Section 410(b)(4)(B) because they do not meet the minimum age and service requirements, be permitted to make salary reduction contributions even in the absence of a specific reference to Code Section 410(b)(4)(B) in the portion of the 403(b) Final Regulations addressing the exclusion of employees who work less than 20 hours per week from the universal availability rule? In contrast, the portion of the 403(b) Final Regulations covering the exclusion of work-study students from the universal availability rule specifically references Code Section 410(b)(4)(B).[41]

    Because the interpretation set forth in the 403(b) Final Regulations reads as somewhat ambiguous, additional clarification would be helpful in shedding light on how these special rules are intended to apply in operation.

[40] We recognize that a legislative solution might be a better resolution but view the merits of such a fix as outside the charter of the EP Subcommittee.
[41] Treas. Reg. §1.403(b)-5(b)(4)(ii)(E).

10. Recommendations

Based on the survey responses and a review of available Service resources and research, it appears that the Service should undertake a project to provide more detailed explanations of its view as to how the universal availability rule applies in operation and offer some suggestions or guidelines that would help promote or enhance compliance. We recommend the following in this regard:

- The EPCU should publish its findings from the Higher Education Institutions project and the K-12 Schools project, as soon as possible, in order to provide similarly situated employers with more relevant guidance regarding the application of the universal availability rule and where errors in operation are occurring;
- The Service should continue to work to expand educating the various sectors of the 403(b) community by improving its communication through its website, the 403(b) Fix-It Guide and newsletters about the existence and the compliant application of the universal availability rule;
- Expanded outreach programs, including webinars and public presentations, would be helpful. However, the EP Subcommittee recognizes the Service's current budgetary constraints. Therefore, the Subcommittee recommends prioritizing and engaging in targeted outreach. From the EP Subcommittee's research, it appears that the public school 403(b) community is especially in need of more detailed information and relevant examples (including the proper treatment of bus drivers, janitors, cafeteria workers and part-time employees regarding the universal availability rule); and
- Addressing certain particularly troublesome specific issues that the Service could address as part of its affirmative measures to expand its education in this area in the form of "soft" or other guidance such as:
    - In what manner can receipt of other benefits be conditioned on the employee making, or refraining from making, salary reduction contributions, if at all;[42]
    - How the 20 hours per week and 1,000 hours per year rules works in "real life," practical operation. The communication should stress that employees excluded under the less than 20 hours per week rule must also be tested under the 1,000 hours standard;
    - The negative consequences that can ensue when an employer fails to provide the annual "effective opportunity" communication about a

[42] Treas. Reg. §1.403(b)-5(b)(2).

participant's ability to begin or change regular 403(b) and Roth 403(b) elective deferrals;

- The importance of the plan sponsor describing the terms of eligibility to participants;
- That employees in such categories as: adjunct instructors, adjunct lecturers, adjunct professors, student assistants, student and summer interns, substitute teachers, part-time employees, visiting professors, teaching fellows, bus drivers, janitors, cafeteria workers, seasonal employees, and temporary employees cannot be excluded if they satisfy the 20 hour per week or 1,000 hours thresholds to be eligible to make salary reduction contributions regardless of job titles or classifications; and
- What happens when the job classification of a member of an excludable class changes in the middle of a year? For example, if a work-study student becomes a part-time employee mid-year, do the hours reasonably anticipated to be worked for the plan sponsor as a part-time employee take into account those already performed as a work-study student?

In sum, it seems to the EP Subcommittee that without heightened emphasis on educating 403(b) plan sponsors about the impact and operation of the universal availability rule, extensive noncompliance will continue to exist.

B. Compliance under "orphan" 403(b) contracts

1. Background

Under the 403(b) Final Regulations, the Service required, for the first time, that 403(b) plans comply in both form and operation with Code Section 403(b) rules, [43] the result of which was that all such plans were required to have in place sufficient written plan documents. At the same time, it has long been common practice in the 403(b) sector to provide (or otherwise make available) multiple plan vendors and contracts. In an effort to facilitate compliance in these circumstances, the 403(b) Final Regulations also require that current vendors be listed in the plan documents and the plans coordinate administration with certain former vendors via information sharing agreements.[44]

[43] Treas. Reg. §1.403(b)-3(b)(3)(i).
[44] Treas. Reg. §1.403(b)-10(b).

Issues arose as to the treatment of contracts to which plan contributions were no longer being made as of the effective date of the 403(b) Final Regulations (generally referred to herein as "orphan" contracts). This date was generally the first plan year beginning in 2009.[45]

Rev. Proc. 2007-71 addressed the treatment of two types of orphan contracts, for plan document compliance purposes, as follows:

> *Former employee contracts issued before 2009:* The vendor for a pre-2009 contract held by a former employee need not be listed in the plan document (and the contract is not subject to the information sharing requirements) if no contributions are made to the contract after 2008.[46]
>
> *Pre-2009 frozen contracts issued to current employees after 2004:* Employee contracts issued from 2005-2008 can be excluded from listing in the plan document (and not be subject to the information sharing obligations) if no contributions are made after 2008 and reasonable, good faith efforts to otherwise "include" such contracts as part of the plan (presumably for operational purposes) are made.[47]

While the guidance did not address pre-2005 contracts to which no contributions have been made since 2004, the general assumption has been that such contracts are also not subject to plan document compliance (and the information sharing rules) where contributions have not been made to the contract after 2004 (sometimes called "grandfathered" contracts).[48] Although presumably similar to pre-2009 frozen contracts issued **after** 2004, the guidance also did not address the treatment of pre-2009 frozen contracts of current employees issued **prior to** 2005.

2. Compliance concerns

In response to the EP Subcommittee's 403(b) plan survey, a number of respondents commented that there continues to be considerable confusion and uncertainty as to what are a 403(b) plan sponsor's obligations regarding

[45] Treas. Reg. §1.403(b)-11(a).
[46] Rev. Proc. 2007-81, §8.02.
[47] Rev. Proc. 2007-81, § 8.01.
[48] In addition, the 403(b) Final Regulations made clear that this also applies to contracts that were received in an exchange (under Rev. Rul. 90-24) on or before September 24, 2007. Treas. Reg. §1.403(b)-11(g); Rev. Proc. 2007-81, § 2.04.

orphan contracts. This concern was also expressed by members of the 403(b) vendor community with whom we had separate discussions on 403(b) plans.

The primary concern in this area is on-going operational compliance for orphan contracts and their impact on other plan contracts. In general, the 403(b) Final Regulations provides that an operational failure under a contract only affects the continued Code Section 403(b) status of that contract.[49] However, the regulations make clear that, for this purpose, all contracts that an employer established for an individual are treated as one contract.[50] Therefore, in general, an operational failure under one contract of an individual that has multiple contracts through an employer will affect the tax status of all of his or her contracts. What is uncertain is whether, and to what extent, these rules apply to individuals who have both orphan contracts and contracts under the employer's on-going 403(b) plan.

There are number of areas in which this is a realistic, on-going concern for plan sponsors. For example, while Rev. Proc. 2007-81 generally puts the onus on the vendor to police compliance of pre-2009 former employee contracts, it is unclear what the impact of any failure under such a contract would have on other contracts that the affected individual may have under the employer's plan. The same lack of clarity also applies for pre-2009 frozen employee contracts subject to the special Rev. Proc. 2007-81 plan document rules, especially since these rules otherwise require that the employer make reasonable, good faith efforts "to include the contract as part of the employer's plan."[51] And, although potentially less of a concern (given the period of time that has elapsed since their issuance), similar concerns also carry over to frozen pre-2005 contracts.

In addition, as noted above, there appears to be a gap in the guidance issued under Rev. Proc. 2007-81 on orphan contracts, as it does not address the treatment of pre-2009 frozen employee contracts that were issued before 2005 (but to which contributions did not stop until afterward). While it might be logical to treat these contracts in the same fashion as pre-2009 frozen contracts issued to current employees after 2004, the Rev. Proc. is silent on this subject and, to our knowledge, no other guidance has been issued on the topic. This leaves 403(b) plan sponsors to guess how they should treat such

[49] Treas. Reg. §1.403(b)-3(d)(1)(i).
[50] Id.
[51] Rev. Proc. 2007-81, §8.01.

contracts compliance-wise (both in form and operation) and what impact they may have on other contracts that the individual involved may have.

In sum, in the EP Subcommittee's view, considerable confusion and uncertainty persists as to when and how orphan contracts impact operational compliance of non-orphan contracts. This is no idle concern since current sample Information Document Requests (IDRs) used for 403(b) plan audits that we have seen ask for information/documentation concerning pre-2009 vendors that no longer receive contributions.

3. **Recommendations for orphan contracts**

To encourage and foster a better understanding of what is required in this context, the EP Subcommittee recommends that the Service consider issuing guidance that clarifies:

- The impact of operational violations under an individual's orphan contract on any other contracts that the individual may have with the same employer; and
- How pre-2009 frozen contracts issued to current employees **before** 2005 should be handled for compliance purposes.

While formal guidance (such as a notice or revenue ruling) might be preferable, the EP Subcommittee recognizes the inherent difficulties in developing and issuing such guidance. The EP Subcommittee suggests, though, that (given the regulations and other formal guidance that have already been issued) it should be possible to address this subject in "soft" guidance. Two examples of where this might be appropriate are: (i) Internal Revenue Manual (IRM) section 4.72.13.9, which addresses "Funding Vehicles" for Section 403(b) plans, and (ii) the on-line article on the written program requirements (found at http://www.irs.gov/Retirement-Plans/IRC-403b-Tax-Sheltered-Annuity-Plans-Written-Program). It may also be appropriate to address this in the 403(b) plan "frequently asked questions" (found at http://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-403(b)-Tax-Sheltered-Annuity-Plans) or a separate article in the newsletters sent to plan sponsors and practitioners.

C. Minimizing contract leakage

1. Background

In general, a growing concern in the retirement sector has been the unnecessary leakage of retirement savings (including 403(b) plan assets). The focus here is the withdrawal or loss of an individual's retirement assets from tax-free solution prior to the time that the individual reaches retirement age. This can occur not only on account of actions taken by the individuals themselves (e.g., through early withdrawals), but due to circumstances over which the individuals have little or no control.

2. Concerns

Concerns have been raised with the EP Subcommittee regarding the unnecessary leakage in several respects under orphan and other contracts. First, given the lack of guidance as to what can be done when there is no longer an employer (or where the employer has no legal involvement), it has been observed that oftentimes the only distribution option vendors are willing to make available to the contract holder is a total distribution. In these circumstances, many vendors are apparently unwilling to allow loans, partial withdrawals or transfers/rollovers to another 403(b) contract to the extent employer approval is required. Second, respondents to our survey, as well members of the 403(b) vendor community with whom we had separate discussions, expressed concerns that orphan and other older annuity contracts are going unclaimed or otherwise getting lost. What they are seeing is that contract issuers are often not making sufficient efforts to keep in contact with the contract holders, resulting in "lost" contracts. We have been told that this is happening because there is no clear-cut obligation for issuers of old fixed annuity contracts to maintain current information/records regarding or otherwise find the holders of these contracts.

3. Recommendations for minimizing contract leakage

Based on the foregoing, we have the following recommendations:

- Greater certainty is needed as to what the vendor can do under a contract in terms of withdrawal and distribution where there is no employer involvement. Therefore, the EP Subcommittee recommends that the Service consider issuing guidance that clarifies that the vendor can act as

the decision-maker (in lieu of the employer) for rollover and other withdrawal/distribution purposes under contracts where the employer no longer exists (or is no longer legally involved). The EP Subcommittee believes this could be done in the form of soft guidance.

- The EP Subcommittee is of the view that issuers should generally be required to do more to ensure that orphan annuity contracts do not go unclaimed. Code Section 401(a)(9) minimum required distribution (MRD) rules could, in our view, provide a potential avenue for the Service to encourage this. We recognize that the regulations generally provide that the required MRD for one contract can be made from another contract held by the individual.[52] Nevertheless, we believe that the Service could issue guidance that requires issuers to provide reasonable advance notice to: (i) contract holders on the MRD requirements, and (ii) if the issuer does not have current contact information, make reasonable efforts to locate the contract holder. This would impose a reasonable, sensible obligation on affected issuers that would help to minimize unclaimed contracts.

D. Terminating a Section 403(b) plan

1. Background

The 403(b) Final Regulations, issued in 2007, expressly allow an employer to terminate its 403(b) plan.[53] After Treasury issued the regulations, 403(b) plan sponsors, vendors and practitioners raised numerous practical questions about the proper way to terminate a 403(b) plan. In response, Treasury issued Rev. Rul. 2011-7, which analyzed four fact situations:

- Situation 1: A plan with individual annuity contracts;
- Situation 2: Situation 1 plus group annuity contracts;
- Situation 3: Situation 2 plus individual and group custodial accounts; and

[52] See Treas. Reg. §1.403(b)-6(e)(7).

[53] Treas. Reg. §1.403(b)-10(a)(1) reads in its key part as follows:

> A section 403(b) plan is permitted to contain provisions that provide for a plan termination and that allow accumulated benefits to be distributed on termination. However, in the case of a section 403(b) contract that is subject to the distribution restrictions in §1.403(b)-6(c) or (d) (relating to custodial accounts and section 403(b) elective deferrals), termination of the plan and the distribution of accumulated benefits is permitted only if the employer (taking into account all entities that are treated as the employer under section 414(b), (c), (m), or (o) on the date of the termination) does not make any contributions to any section 403(b) contract that is not part of the plan during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan.

- Situation 4: Situation 3 in the context of a money purchase pension plan that is required to provide distributions in the form of annuities (unless the participant elects otherwise with spousal consent).

In each situation, the Revenue Ruling (Rev. Rul.) states as facts that the employer adopts a resolution to cease contributions and terminate the plan at a specified date. Situation 1 provides that the plan make distributions to all participants and beneficiaries by delivery of fully-paid individual annuity contracts or single-sum payments as soon as administratively practicable after the termination date; following the termination, participants and beneficiaries who hold the fully-paid insurance annuity contracts are entitled to payments in accordance with the terms of the contracts. In Situation 2, some of the contracts are group annuity contracts. The distributions from the group annuity contract are in the form of individual certificates representing the participant's or beneficiary's interest in the group contract.

In Situations 3 and 4, some of the participants and beneficiaries have custodial accounts. Under the facts, the custodial accounts include language allowing the custodian to make a direct transfer of the custodial account to an IRA account or annuity or other eligible plan of the participant or beneficiary. While the Rev. Rul. answers many questions, our survey and discussions with 403(b) sponsors and vendors showed that confusion about the rules still exists, especially with respect to individual custodial accounts. The major concern appears to be that some custodial accounts cannot be distributed because of lack of participant cooperation, and without distribution the plan cannot be terminated.[54]

2. IRS website information

The 403(b) Fix-It Guide, an online tool that survey respondents felt was very helpful in general, is not particularly helpful with respect to plan terminations. The Guide does not address problems that can occur in terminating a plan.

The Service's web page contains a specific section on terminating a 403(b) plan. The page, which is regularly updated (it was last updated on September 30, 2014), discusses the process without any recognition of the problems. The discussion on the webpage assumes everything goes easily and there

[54] A 403(b) plan is not terminated if all assets aren't distributed as soon as administratively practicable after the termination. In accordance with Rev. Rul. 89-87 (relating to wasting trusts), this generally requires distributions within 12 months of the termination date.

are no problems. It is of little, or no, help when the sponsor runs into difficulties distributing all plan benefits.

The Service provides its compliance staff with guidance on examining 403(b) plan terminations in its compliance manual.[55] The manual takes an absolute position that the plan is not terminated if all assets are not distributed timely. It provides no guidance or recognition of the practical problems sponsors are facing in terminating a plan.

3. **Discussion**

That the Service is attempting, for many good reasons, to treat 403(b) arrangements as plans similar to 401(k) arrangements does not change the

[55] I.R.M. 4.72.13.17 (11-12-2014) Plan Terminations.

1. An IRC 403(b) plan may contain provisions allowing the plan sponsor to terminate the plan and make distributions. See Treas. Reg. 1.403(b)-10(a) and Rev. Rul. 2011-7.
2. Termination of an IRC 403(b) plan involves the distribution of each participant's accumulated benefit. Delivery of a fully paid individual insurance annuity contract is treated as a distribution. See Rev. Rul. 2011-7.
3. Termination of the IRC 403(b) plan and the distribution of accumulated benefits is permitted only if the employer does not make contributions to any IRC 403(b) contract that is not part of the plan during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan. See Treas. Reg. 1.403(b)-10(a)(1).
4. There is an exception to the general rule as stated in paragraph (3). If for the period beginning one year before the date of the plan termination and one year after the date of the distribution of all assets from the plan, less than 2 percent of eligible employees are eligible under the alternative IRC 403(b) plan, the alternative IRC 403(b) contract is disregarded. See Treas. Reg. 1.403(b)-10(a)(1).
5. Alternatively, an IRC 403(b) plan may contain provisions allowing the sponsor to freeze the plan by eliminating future contributions or by limiting participation to existing participants and employees. See Treas. Reg. 1.403(b)-10(a)(1).

Note: The frozen plan is still required to meet the nondiscrimination requirements for IRC 403(b) plans. See Treas. Reg. 1.403(b)-10(a)(1) and Treas. Reg. 1.403(b)-5. I.R.M. 4.72.13.17.1 (11-12-2014)

Plan Termination - Examination Steps

1. Review the plan document.

A. Determine whether it contains provisions allowing for termination of the plan.

B. Review all amendments to determine if an amendment terminating the plan has been adopted.

2. Document whether distributions have been made to all participants as soon as is administratively practicable (generally within one year) following the date of termination.
3. Document whether distribution of all accumulated benefits have been made to all the participants. In lieu of a distribution of cash, the termination may be accomplished by the delivery of a fully paid individual insurance annuity contract to the participant.

Note: If distribution does not occur to all participants, the plan is not terminated and Form 5500 filing requirements may be applicable.

4. Document whether the employer continues to be an eligible employer under IRC 403(b).
5. In the case of an employer no longer eligible to maintain an IRC 403(b) plan, and where the plan has not been terminated, consider the ineligible employer remedy under EPCRS.

basic fact that in a 403(b) plan - unlike in a 401(k) arrangement where plan sponsors are the driver - participants and vendors, and not plan sponsors, control many aspects of plan operations. A 403(b) plan consists of individual (or group) annuity contracts and/or custodial accounts between a vendor and an individual. In many cases, the plan sponsor has only limited control over these various funding vehicles.

Survey respondents repeatedly mentioned that there were problems terminating 403(b) plans with custodial accounts. In short, the Service has taken the position that annuity contracts could be distributed to a participant without the participant's consent; whereas a custodial account could not be distributed similarly. If a participant refuses to take a distribution, or cannot be found to take a distribution, the custodial account remains in the plan. The EP Subcommittee is not questioning the Service's legal reasoning.[56] However, the absence of a practical solution for terminating 403(b) plans that includes custodial accounts is causing 403(b) plan sponsors additional legal and operational costs and the need to follow questionable solutions.

For purposes of this discussion, assume a 403(b) sponsor with custodial accounts desires to terminate its 403(b) plan and all participants, but one, agree to a termination distribution and rollover. Participant A does not agree to a distribution, either because he or she cannot be found, is confused about the tax implications or just does not want to cooperate with the sponsor. A plan is not considered terminated unless all assets are distributed as soon as practicable (generally, one year). Thus, in theory, all of the other rollovers made earlier from the 403(b) plan are invalid because the distribution was not from a terminating plan. Further, the 403(b) plan sponsor is still considered to have a continuing plan for purposes of ERISA (if the plan is a covered plan) and must continue to file Form 5500 annual reports.

One respondent told the EP Subcommittee that in many cases the plan sponsor will document that it is terminating the plan and that the "former" sponsor now considers the contract to be between the custodian and the participant. The sponsor will then file a final Form 5500. While this may be a practical approach, it is not clear that the 403(b) plan would be treated as terminated under existing Service guidance.

[56] Some of the responses to the EP Subcommittee from lawyers representing 403(b) plans indicate some confusion over the reasoning for this position, and complain that the Service has not provided any statement of the legal basis for the position.

The Service needs to recognize these practical problems and provide options for 403(b) plan sponsors. Ideally, many of the problems will be dealt with by legislation or regulation, but that may take considerable time. In the interim, uncertainty and questionable practices exist.

Our recommendations are aimed at providing full disclosure of the problems, especially for less sophisticated plan sponsors and advisers who do not specialize in administering 403(b) plans. The Service can do much of this through its website and publications without any change of law or regulatory action. Ideally, we would like to see the Service provide a clear means for 403(b) plans to be terminated – perhaps through creating a good faith or de minimis rule. At the moment, it is our understanding, that some sponsors are adopting their own practical rules to address the problem because it is impractical to tell participants to undo rollovers and to continue to treat the plan as ongoing (e.g., continue filing annual Forms 5500 for an ERISA-covered plan).

4. Recommendations

The Service should explore with Chief Counsel whether the Service has legal authority to create good faith or de minimis rules or provide other solutions to address the practical problems of terminating a 403(b) plan.

- If the Service does not have legal authority to solve the practical problems, Treasury should seek legislation addressing the problems or giving the Service authority to address the problems in guidance.
- Regardless of the above recommendation, the Service should expand its webpage with information on terminating a 403(b) plan. The current webpage explains how to terminate a 403(b) plan but does not recognize or address the many practical problems sponsors and practitioners face when they actually try to do a termination. The Service's revised webpage should identify these issues and suggest possible solutions.
- The 403(b) Fix-It Guide should be expanded to address appropriate corrections for situations where termination distributions have been made and rolled over, only to see the termination fail because all assets cannot be distributed.

E. Employee Plans Compliance Resolution System suggested improvements

1. Introduction to EPCRS

Corrections of operational errors within 403(b) plans may be made under the current version of EPCRS program[57]. Although the current guidance is provided in a 2013 Rev. Proc. and modified by a 2015 Rev. Proc., EPCRS, or some form of it, has been in place since the early 1990s and the title of EPCRS in place since 1998. During this time, EPCRS has continued to evolve to address the changing needs of the retirement plan community. The EP Subcommittee commends the Service's commitment to the program.

With the release of the current EPCRS, the program was expanded in many respects. The largest single expansion was the inclusion of 403(b) plans in the program with consideration given to the issues of the 403(b) community in matters that are similar to the issues experienced in connection with 401(a) plans. Specifically, the following adaptations were added with respect to 403(b) plans:

- Provides treatment for 403(b) operational plan failures similar to those for qualified plans (with exception for errors occurring prior to January 1, 2009);
- Makes the Voluntary Compliance Program available to 403(b) plan sponsors who failed to timely adopt a written plan; and
- Provides for reduced user fees for late adopters of a written 403(b) plan.

2. Overview of EPCRS

EPCRS is a system consisting of three distinct parts: Self-correction Program, Voluntary Correction Program, and Audit Closing Agreement Program. A brief summary of each component is below:

Self-correction Program (SCP)

- Only available for operational failures, where the plan sponsor has failed to follow the terms of the plan;
- Corrections are made without filing with the Service or the payment of a fee;

[57] Rev. Proc. 2013-12, as modified by Rev. Proc. 2015-27.

- Plan sponsor should be able to identify the scope of the error and what caused it;
- Practices or procedures designed to keep the error from occurring again should be documented and implemented; and
- Significant errors may be corrected within two years using this method for qualified plans with either a favorable determination letter or an advisory opinion letter from the Service, or for 403(b) plans.

Voluntary Correction Program (VCP)

- Corrections cover not just operational failures but also plan document, demographic and employer eligibility failures;
- Available to sponsors of qualified plans, 403(b) plans, SEPs or Simple IRAs;
- The program consists of a required filing with the Service and the payment of a specified fee, depending on the type of error;
- Once approved, the plan sponsor receives a “compliance statement” wherein the Service approves of the correction method;
- The program makes available group and anonymous submissions; and
- Not available to plan sponsors once notified they are subject to a Service audit.

Audit Closing Agreement Program (Audit CAP)

- Program is available to a plan sponsor subject to audit;
- Consists of a negotiated correction of an identified failure; and
- Requires the payment of a sanction that varies depending on the nature and severity of the plan failure.

3. Recommendations for further improvements to EPCRS

a. Expansion of SCP

Allow Certain Participant Loan Errors to be Self-Corrected

Currently, SCP does not permit the self-correction of errors involving participant loan transactions of any sort. Such errors can only be corrected through VCP or Audit CAP. Within the retirement plan industry as a whole, it is widely understood that participant loan programs have a large propensity for errors due to the specific nature of the regulations governing them, the number of parties involved in the establishment of a participant loan and the repayment process, and

the tendency for participant loans to be high-volume transactions within a plan.

Through the EP Subcommittee's discussions with 403(b) industry professionals and the responses to the EP Subcommittee's survey, there is a need for the expansion of SCP to include correction of participant loans in instances where the loan exceeded the statutory limit of Code Section 72(p)(2)(A), the terms of the loan did not satisfy Code Section 72(p)(2)(B) or (C), and defaulted participant loans where the terms satisfied Code Section 72(p)(2) but the loan is not paid back in a timely manner. Specific emphasis should be placed on the defaulted participant loan situations which is the most prevalent error, and the error that is most likely not to be fully corrected due to the perceived onerous nature of VCP by plan sponsors.

There are several complexities specific to participant loan error issues faced by 403(b) plans that enhance the importance of devising a self-correction option for these matters for the 403(b) community.

In a typical qualified plan scenario, assets are held by a single custodian, or possibly a custodian and a self-directed brokerage account vendor that has links to the custodian or record-keeper. In a typical 403(b) plan scenario, the assets may be scattered among multiple vendors with each participant having an individual account. In the survey results, the EP Subcommittee received numerous reports of non-friendly vendors, as well as confusion among multiple vendors regarding loan reporting and communication regarding loan initiation.

As a result of the very nature of the 403(b) operational structure, even the most diligent and attentive plan sponsor often finds itself in the position of discovering participant loan errors after the loans have already been issued incorrectly or have gone into default. It is also a frequent scenario that plan sponsors discover a participant loan error with one vendor and then a few months later find another participant loan error with another vendor. This creates a perpetual cycle, and excessive costs, of having to file through VCP for these types of corrections. Anecdotally, and as reflected in the survey results, this is one of the reasons that plan sponsors are choosing not to fully correct the matter in operation (or to address the matter outside of VCP procedures) when they find a participant loan error.

Another strong driving force behind the reluctance of 403(b) plan sponsors to utilize VCP to correct participant loan errors is the overall cost involved. While the current VCP user fee structure allows for computation of the fee based on the actual number of participants with loan errors, as opposed to the number of plan participants, a majority of 403(b) organizations are non-profit and operate on a very tight budget. By requiring a VCP filing, instead of SCP treatment, a much greater cost of correction is created. An organization with 10 participant loan errors would be faced with only a $300 user fee, but the costs involved with hiring a practitioner to prepare and submit the VCP filing, would still be cost prohibitive.[58] This is leading to the decision by plan sponsors to partially, or not-at-all, correct the errors.

Another unique quality of the 403(b) plan sponsor that drives the recommendation to allow participant loan failures to be corrected through SCP is embedded in the structure of 403(b) arrangements. Many 403(b) plans are not subject to ERISA. These types of 403(b) plan sponsors are very careful not to engage in activities that might result in it being subject to ERISA and its fiduciary rules. One such activity that they fear would trigger this is the policing of participant loans and, if they ultimately become delinquent, the filing of a VCP application. So, while there may be an important public policy goal of having loan failures corrected, the plan sponsor, which is the entity that is in the best position to take the steps toward that goal, has a competing interest that prevents it from doing so.

Even if the Service is not willing to open SCP for loan correction for all types of plans, the EP Subcommittee recommends, due to the unique aspects of 403(b) plan problems noted above, the expansion of the SCP to include correction for vendor or employer-caused loan failures in 403(b) plan. The correction should adhere to the correction principles outlined in EPCRS Rev. Proc. 2013-12, Section 6.07(1). This should include not treating the failure as a deemed distribution.

Expanded use of the DOL earnings calculator

As noted above, it is not uncommon for an employer who sponsors a 403(b) plan to have or permit multiple contracts with a variety of

[58] Rev. Proc. 2015-27, Section 4.13, modifying Rev. Proc. 2013-12, Section 12.02(3).

providers and/or contracts (at least some of which may be orphan contracts), which could make it administratively difficult and costly to compute a participant's actual return for correction purposes. In such circumstances, we believe that it would be reasonable and appropriate to allow the plan sponsor to use the DOL earnings calculator as is provided for in the Voluntary Fiduciary Correction Program to compute lost earnings. Therefore, we recommend that EP interpret and apply EPCRS as allowing for such immediately, and it can clarify the language in the next EPCRS revision.

4. Special application process for 403(b)

Throughout the EP Subcommittee's discussions with stakeholders within the 403(b) realm, there was a continuing notion regarding the need for a special application process for VCP filings. The concerns raised were varied, but from them arose three primary issues that are unique to 403(b) plans.

First, the new requirement that 403(b) plans have to be embodied in a written plan document (generally effective January 1, 2009) required 403(b) plan sponsors to memorialize the terms of the plans. Sometimes, however, the plan document did not accurately reflect the administration of the plan in the specific terms of the final document. Thus, operational errors were created. In many cases, these issues were created by purveyors of plan services that provided plan documents to plan sponsors without having specific experience on the nuances related to 403(b) plan document provisions. Many 403(b) plan sponsors, especially small ones, also did not have outside lawyers or consultants with 403(b) expertise. As a result, plan sponsors were often unable to proactively identify plan language problems prior to signing the documents.

Another specific class of issues deals with problems that 403(b) plan sponsors experience with vendors who are uncooperative or unresponsive to efforts to correct errors reaching across multiple contracts or individual contracts that do not recognize the role of the plan sponsor. Many of these contracts are written as agreements between the service provider and the participant, which the employer agrees to facilitate through its payroll system. There is no provision for the administration of plan-wide matters by the employer. In other cases, with many legacy contracts or arrangements, the terms do not facilitate the fix that is prescribed by EPCRS for the "plan" and

the employer doesn't have the ability to force the account holder (participant) to take the actions necessary to bring the contract into plan-level compliance.

To address some of the challenges mentioned above, the EP Subcommittee makes two key recommendations. First, the Service should develop additional schedules for the VCP filing to allow for correction of the most common 403(b) operational failures. For example, the Service should develop a schedule specifically addressing a universal availability failure with clear instructions on the correction options (similar to Schedule 5 and the loan corrections). Second, the Service should also develop separate, more 403(b)-specific Appendix C, Schedule 1 and Schedule 2 for 403(b) plans. This would simplify the process for the 403(b) plan sponsors and would allow the Service to better tailor the process for this community.

5. Availability of discounted fees for Section 403(b) plan adopters

In the EP Subcommittee's survey of 403(b) plan sponsors and service providers, we received many comments concerning the fees associated with the VCP submission process. Some of these comments were focused on the fact that members of the not-for-profit community are operating with fewer and fewer budgetary dollars to provide competitive benefit offerings for their employees, and that the compliance costs relative to the nature and amount of the various fixes are disproportionate. This same budgetary issue also applies to K-12 and higher education institutions. Additionally, donors to the charitable organizations, or taxpayers funding schools, perceive the organization in the light that their contributions are going to the Service and legal representation, rather than the organizational purpose itself, hurting fundraising.

There is also concern relative to the amount of the assessed fee and size of the employer – particularly for the very small non-profit. Some survey responders suggested implementing a flat fee of $200 for employers in the lowest size range, and incremental amounts thereafter for larger organizations. Additional comments were provided by the survey respondents stating that many plans have a much greater number of participants reported on the Form 5500 than actual employees due to terminated employees with individual contracts that are difficult to distribute due to a number of reasons, including missing participants, non-responsive participants and lack of cooperation from vendors.

With the opening of the new 403(b) plan pre-approved document program[59], for which document providers will be filing with the Service no later than April 30, 2015, the resulting number of discovered non-compliant 403(b) plan sponsors is likely to spike during the restatement period beginning in 2017. This spike will be related not only to newly discovered non-amenders from the original 2009 deadline, but as experienced with qualified plans, operational errors will be brought to light as a natural part of the restatement process. Because this will be the first time the 403(b) plan community will be experiencing the restatement process, the volume of errors discovered has the potential to be quite extensive. If the VCP fees and expenses remain outside of the budgetary availability for these organizations, there will be extensive non-compliance with the Code. The EP Subcommittee recommends reducing the fees for the 403(b) community, if only for a reasonable period of time, to allow these compliance errors to be discovered and corrected. This would be a tremendous benefit to all parties involved.

As the EP Subcommittee wrote in the 2014 EP Report, we agree that there should be a strong push to encourage 403(b) plan sponsors to adopt a pre-approved plan document. Another suggestion that the EP Subcommittee would like to propose for consideration is an amnesty program for any 403(b) plan sponsor who previously failed to timely adopt a plan document that would work in conjunction with the pre-approved program. What the EP Subcommittee envisions is that if such a 403(b) plan sponsor timely adopts a pre-approved document, the past document error would automatically be deemed corrected under EPCRS, provided that any needed plan documentation for the period of noncompliance has been (or will be) retroactively adopted in conjunction with implementing the pre-approved plan document. This program would serve multiple purposes. First, it would encourage the adoption of pre-approved documents. Second, it would reduce the number of plan sponsors that would need to file a VCP application with the Service, reducing a possible burden for the Service and its limited resources. Lastly, it would prevent these non-profit and public organizations from spending their limited resources on a pro forma correction action.

6. Recommendations for EPCRS improvements

The EP Subcommittee of the ACT recommends the following changes to the EPCRS program be considered by the Service:

[59] Rev. Proc. 2013-22.

- Expand the SCP portion to include correction for common loan failures adhering to the correction principles outlined in EPCRS Rev. Proc. 2013-12, Section 6.07(1). Further, such correction, where the failure is caused by the employer or vendor, would not be treated as a deemed distribution.
- Allow plan sponsors to use the DOL earnings calculator (as is provided for in the DOL's Voluntary Fiduciary Correction Program) to compute lost earnings.
- Develop additional schedules for the VCP filing to allow for correction of the most common 403(b) operational failures.
- Develop a separate more 403(b)-specific VCP Appendix C, Schedule 1 and Schedule 2 for 403(b) plans.
- Reduce the filing fees for the 403(b) community, if only for a reasonable period of time, to allow these compliance errors in the remedial amendment period to be discovered and corrected.
- Implement a document amnesty program for any 403(b) plan sponsor that adopts a pre-approved plan so that no correction of prior documents is required.

VI. CONCLUSION

This year, the EP Subcommittee reviewed the current status of the 403(b) community, with specific focus on areas that have resulted in a lower level of compliance with the Code and created excess operational costs. In the EP Subcommittee's recommendations, we attempted to balance the needs of the 403(b) community with the Service's significant lack of resources. The EP Subcommittee's recommendations are intended to provide value to the 403(b) community and be logistically possible for the Service to achieve. The EP Subcommittee recognizes that many of the guidance recommendations made in this Report may go beyond the authority of EP, especially in light of the reorganization within the Service. It is the EP Subcommittee's hope that EP accomplishes what it can through soft guidance, such as web page clarity, and alert Chief Counsel to the recommendations made that go beyond EP's jurisdiction.

After spending significant time interviewing IRS personnel, 403(b) practitioners, and evaluating the comprehensive responses of the 403(b) community survey that the EP Subcommittee published, the following recommendations are presented for consideration by the Service:

A. Provide additional guidance on universal availability

- The EPCU should publish its findings as soon as possible from the Higher Education Institutions and the K-12 Schools projects in order to provide similarly situated employers with more relevant guidance.
- The Service should work to target its educational outreach to specific sectors of the 403(b) community, with special emphasis on the 403(b) public school community, who might not be aware of its website, the 403(b) Fix-It Guide and newsletters.
- The Service should address in the form of "soft" or other guidance on certain particularly troublesome specific issues such as:
  - In what manner can receipt of other benefits be conditioned on the employee making, or refraining from making, salary reduction contributions, if at all.
  - How the 20 hours per week and 1,000 hours per year rules works in "real life," practical operation.
  - The negative consequences that can ensue when an employer fails to provide the annual "effective opportunity" communication about a

participant's ability to begin or change regular 403(b) and Roth 403(b) elective deferrals.
  - The importance of the plan sponsor describing the terms of eligibility to participants.
  - Employees in certain categories cannot be excluded if they satisfy the 20 hour per week or 1,000 hours thresholds and are, therefore, eligible to make salary reduction contributions regardless of job titles or classifications.
  - What happens when the job classification of a member of an excludable class changes in the middle of a year?

B. Clarification for orphan contracts

- The Service should provide additional, practical guidance on the impact of operational violations under an individual's orphan contract on other contracts that the individual may have with the same employer.
- Clarify how pre-2009 frozen contracts issued to current employees **before** 2005 should be handled for compliance purposes.

C. Minimize 403(b) contract leakage

- The Service should consider issuing soft guidance that clarifies that a 403(b) vendor can act as the decision-maker where the employer no longer exists for rollover and other withdrawal/distribution purposes under contracts.
- The Service should issue guidance that requires issuers to provide reasonable advance notice to: (i) contract holders on the MRD requirements, and (ii) if the issuer does not have current contact information, make reasonable efforts to locate the contract holder.

D. Address current gaps in termination guidance

- Treasury should seek legislation addressing the problems or giving the Service authority to address the problems with 403(b) plan terminations.
- The Service should expand its webpage with information on terminating a 403(b) plan to recognize and address the many practical problems sponsors and practitioners face when they actually try to do a termination.

- The 403(b) Fix-It Guide should be expanded to address appropriate corrections for situations where the termination fails because all assets cannot be distributed.

E. Enhance EPCRS to accommodate the unique traits of 403(b) Plans

- The Service should:
  - Expand the SCP portion to include correction for common loan failures.
  - Allow plan sponsors to use the DOL online earnings calculator to compute lost earnings.
  - Develop additional schedules for the VCP filing to allow for correction of the most common 403(b) operational failures.
  - Develop a separate VCP Appendix C, Schedule 1 and Schedule 2 for 403(b) plans.
  - Reduce the filing fees for the 403(b) community, if only for a reasonable period of time, to allow compliance errors uncovered in the remedial amendment period to be discovered and corrected
  - Implement a document amnesty program for any 403(b) plan sponsor that adopts a pre-approved plan so that no correction of prior documents is required.

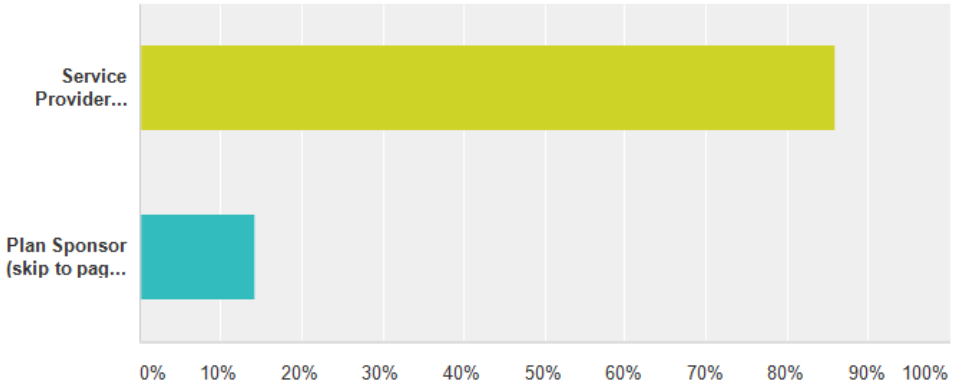
The Service has made great strides in its outreach activities to the 403(b) community including, but not limited to, webinars on various subjects and creating the 403(b) Fix-It Guide specific to the issues of these plans. Unfortunately, many plan sponsors either are unaware of their duties or are trying to avoid having any employer responsibility so that the plan will not be treated as an ERISA plan (with its resultant fiduciary and reporting requirements). Also, many plan sponsors do not have attorneys who are expert in 403(b) plans or staff dedicated to the plan. As a result, much of the Service's educational outreach may not be reaching the sponsors most in need of education.

It is the EP Subcommittee's opinion that the conflict between the desire for the plan sponsor to avoid ERISA status and the need for a responsible governing entity for the plan operation is a significant barrier to effective tax compliance for 403(b) plans. The EP Subcommittee, therefore, recommends that the Service address this matter in inter-agency discussions with the DOL to foster further research and possible guidance that would better define the rules governing the responsibilities of a plan sponsor of a 403(b) plan to satisfy the tax rules without making the plan an ERISA plan.

APPENDIX A
IRS ACT 403(b) Survey Results

Q1 Do you either provide services to 403(b) plans or sponsor a 403(b) plan for your employees?

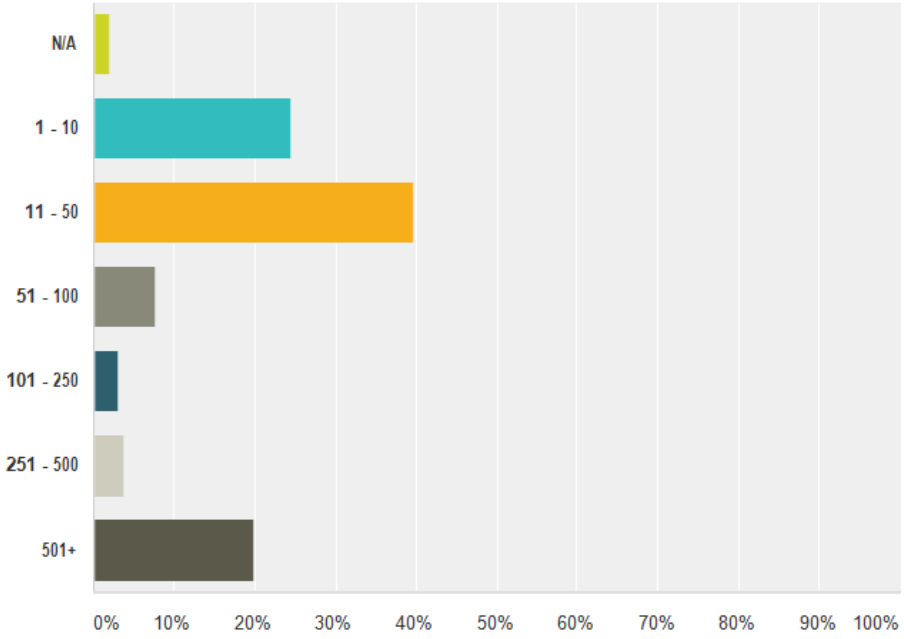
Answered: 163 Skipped: 2



Answer Choices	Responses	
Service Provider (complete pages 2 & 4)	**85.89%**	140
Plan Sponsor (skip to pages 3 & 4)	**14.11%**	23
Total		**163**

Q2 Approximately how many 403(b) plans do you service?

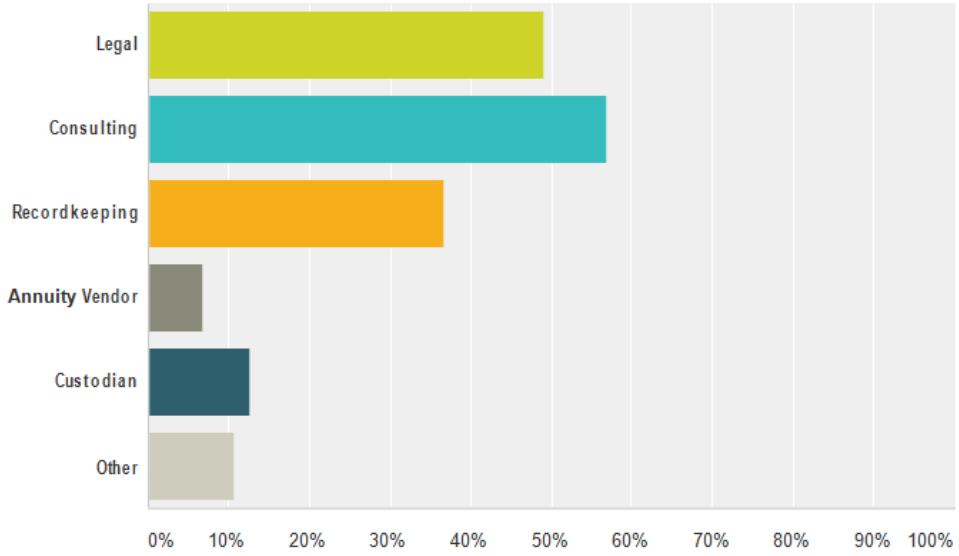
Answered: 106 Skipped: 59



Answer Choices	Responses	
N/A	**1.89%**	2
1 - 10	**24.53%**	26
11 - 50	**39.62%**	42
51 - 100	**7.55%**	8
101 - 250	**2.83%**	3
251 - 500	**3.77%**	4
501+	**19.81%**	21
Total		**106**

Q3 What type of services do you provide for 403(b) plans? (Check all that apply)

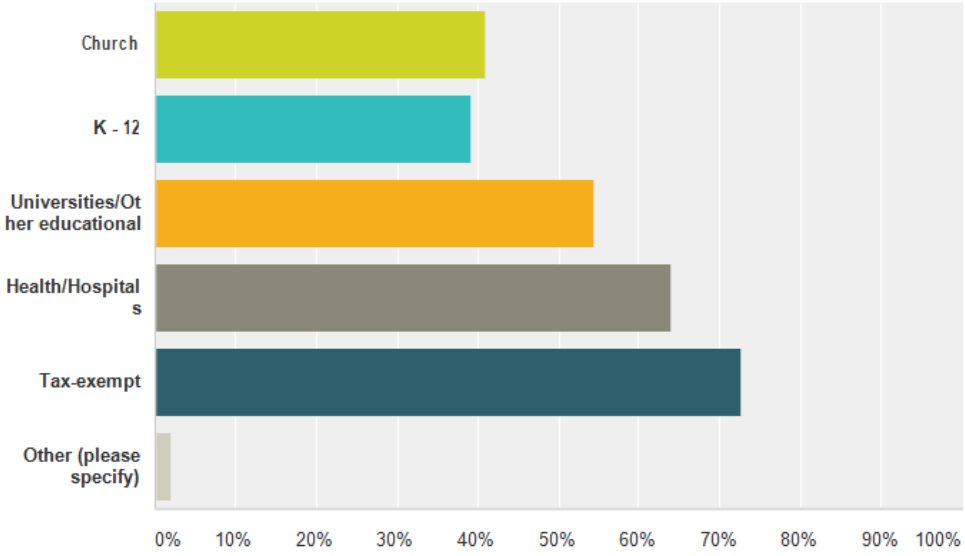
Answered: 104 Skipped: 61



Answer Choices	Responses	
Legal	**49.04%**	51
Consulting	**56.73%**	59
Recordkeeping	**36.54%**	38
Annuity Vendor	**6.73%**	7
Custodian	**12.50%**	13
Other	**10.58%**	11
Total Respondents: 104		

Q4 What types of 403(b) clients do you mainly service? (Check all that apply)

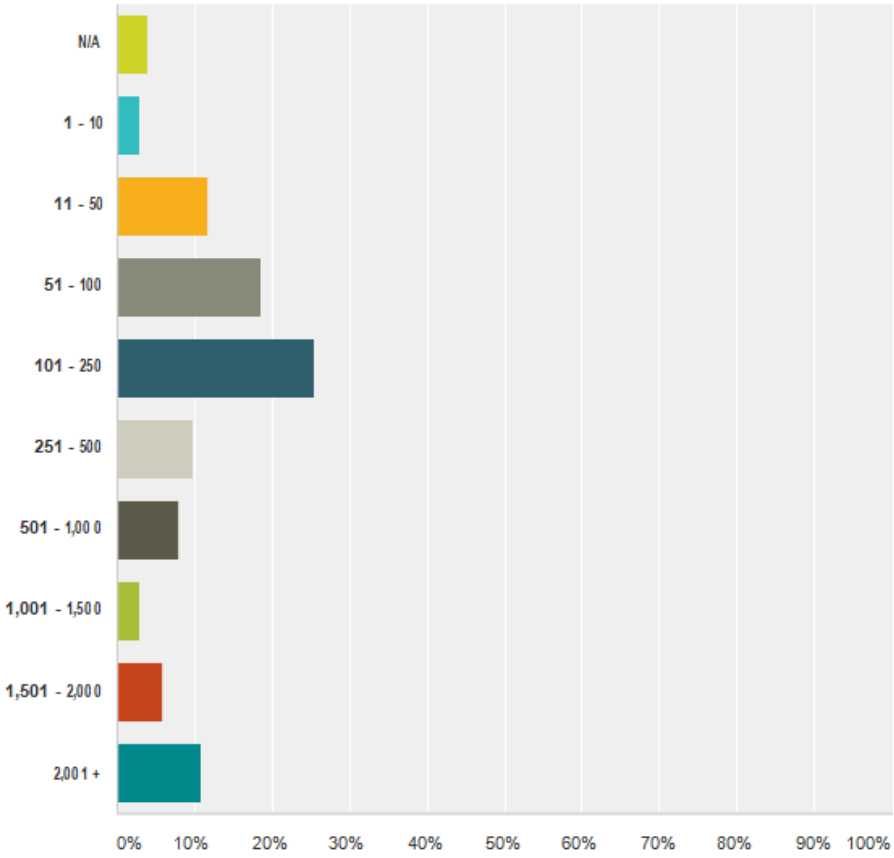
Answered: 105 Skipped: 60



Answer Choices	Responses	
Church	**40.95%**	43
K - 12	**39.05%**	41
Universities/Other educational	**54.29%**	57
Health/Hospitals	**63.81%**	67
Tax-exempt	**72.38%**	76
Other (please specify)	**1.90%**	2
Total Respondents: 105		

Q5 What is the average number of participants under the 403(b) arrangements you service?

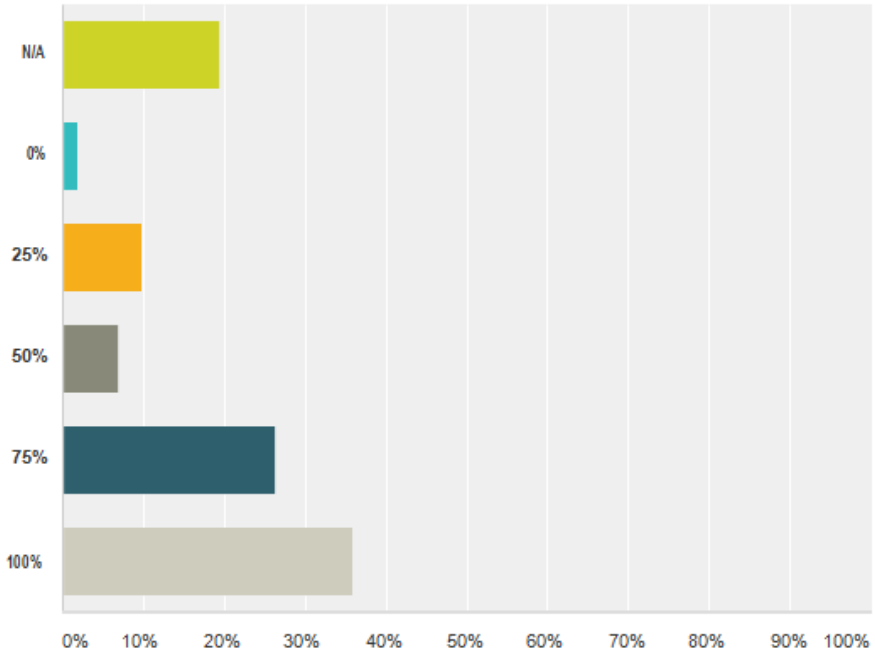
Answered: 102 Skipped: 63



Answer Choices	Responses	
N/A	**3.92%**	4
1 - 10	**2.94%**	3
11 - 50	**11.76%**	12
51 - 100	**18.63%**	19
101 - 250	**25.49%**	26
251 - 500	**9.80%**	10
501 - 1,000	**7.84%**	8
1,001 - 1,500	**2.94%**	3
1,501 - 2,000	**5.88%**	6
2,001+	**10.78%**	11
Total		**102**

Q6 If you currently provide 403(b) plan document services, what percentage of your clients do you estimate will adopt a pre-approved document? (check nearest percentage or N/A)

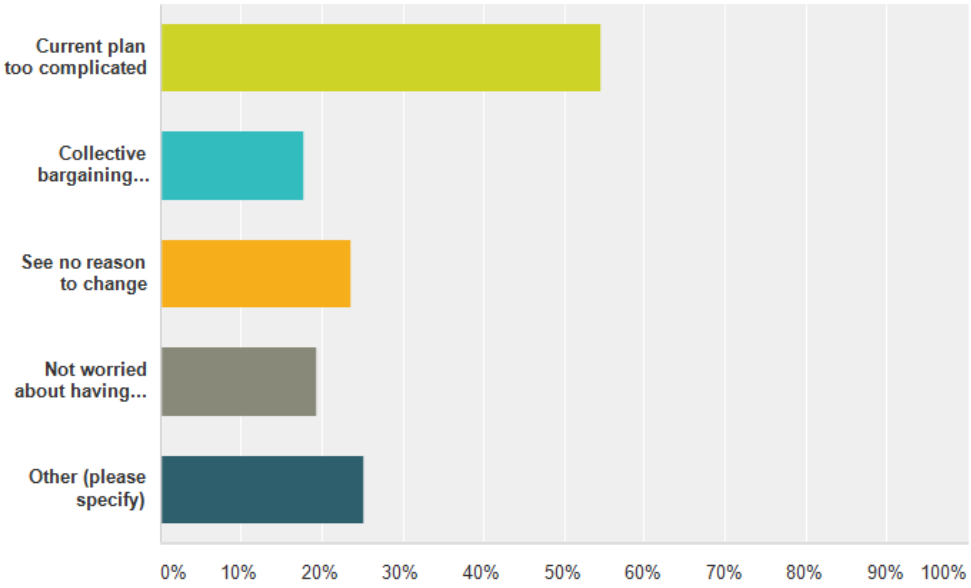
Answered: 103 Skipped: 62



Answer Choices	Responses	
N/A	**19.42%**	20
0%	**1.94%**	2
25%	**9.71%**	10
50%	**6.80%**	7
75%	**26.21%**	27
100%	**35.92%**	37
Total		**103**

Q7 For those clients whom you think will not adopt a pre-approved plan, what is the reason? (check all that apply)

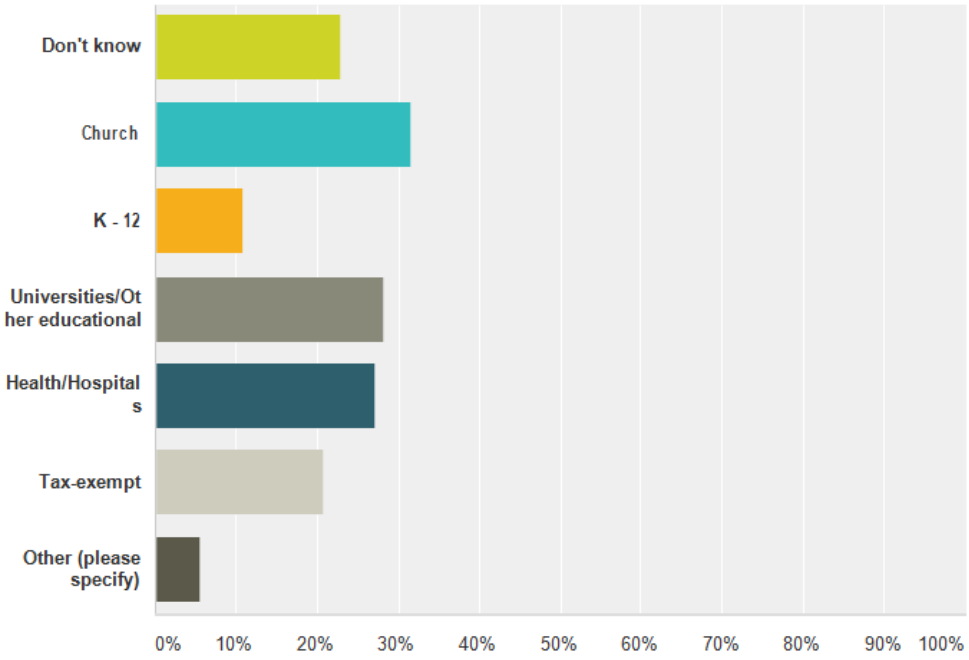
Answered: 68 Skipped: 97



Answer Choices	Responses	
Current plan too complicated	**54.41%**	37
Collective bargaining issues	**17.65%**	12
See no reason to change	**23.53%**	16
Not worried about having an IRS opinion letter	**19.12%**	13
Other (please specify)	**25.00%**	17
Total Respondents: 68		

Q8 Which plan sponsor groups do you see as least likely to adopt a pre-approved plan? (check all that apply)

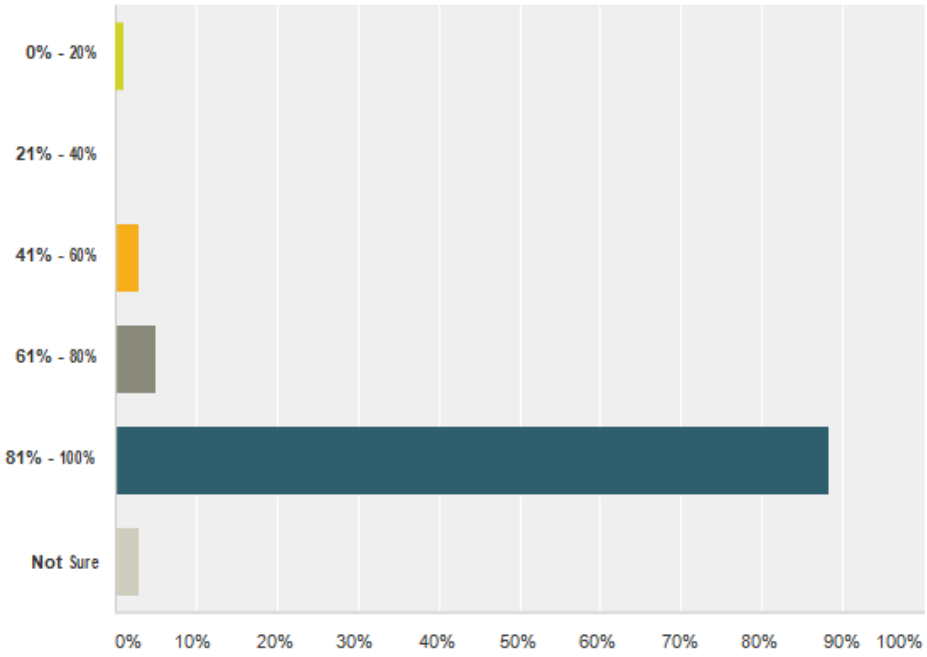
Answered: 92 Skipped: 73



Answer Choices	Responses	
Don't know	**22.83%**	21
Church	**31.52%**	29
K - 12	**10.87%**	10
Universities/Other educational	**28.26%**	26
Health/Hospitals	**27.17%**	25
Tax-exempt	**20.65%**	19
Other (please specify)	**5.43%**	5
Total Respondents: 92		

Q9 What percent of your 403(b) clients do you believe have written plan documents?

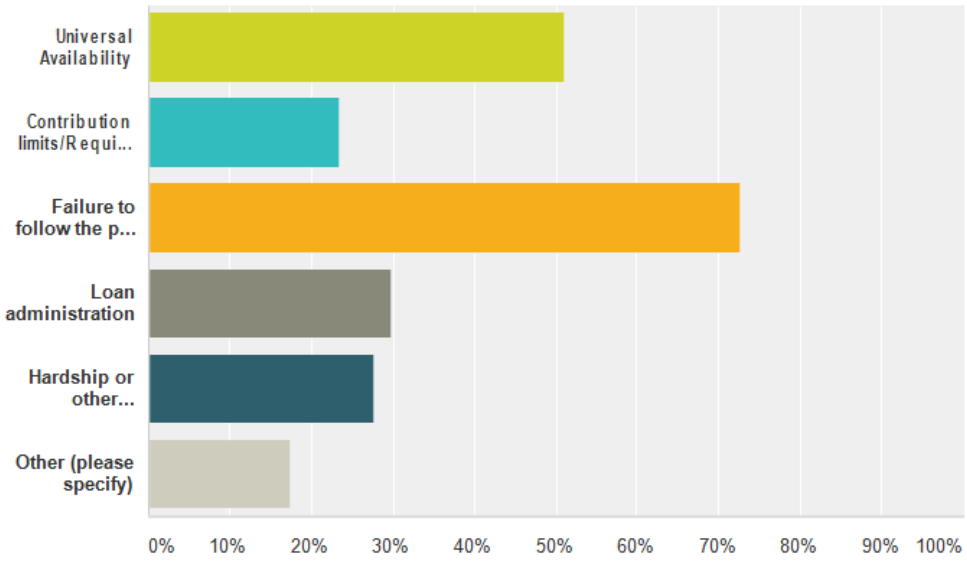
Answered: 100 Skipped: 65



Answer Choices	Responses	
0% - 20%	**1.00%**	1
21% - 40%	**0.00%**	0
41% - 60%	**3.00%**	3
61% - 80%	**5.00%**	5
81% - 100%	**88.00%**	88
Not Sure	**3.00%**	3
Total		**100**

Q10 What do you think are the main topical areas for operational issues?

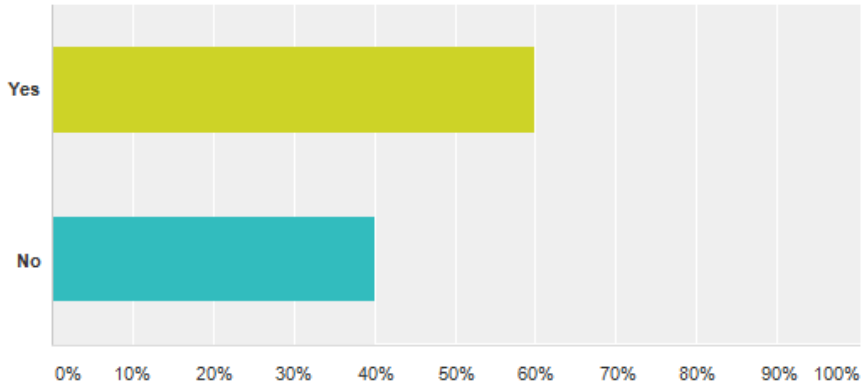
Answered: 98 Skipped: 67



Answer Choices	Responses	
Universal Availability	**51.02%**	50
Contribution limits/Requirements	**23.47%**	23
Failure to follow the plan document	**72.45%**	71
Loan administration	**29.59%**	29
Hardship or other in-service withdrawals	**27.55%**	27
Other (please specify)	**17.35%**	17
Total Respondents: 98		

Q11 Have any of your 403(b) clients chosen to use VCP?

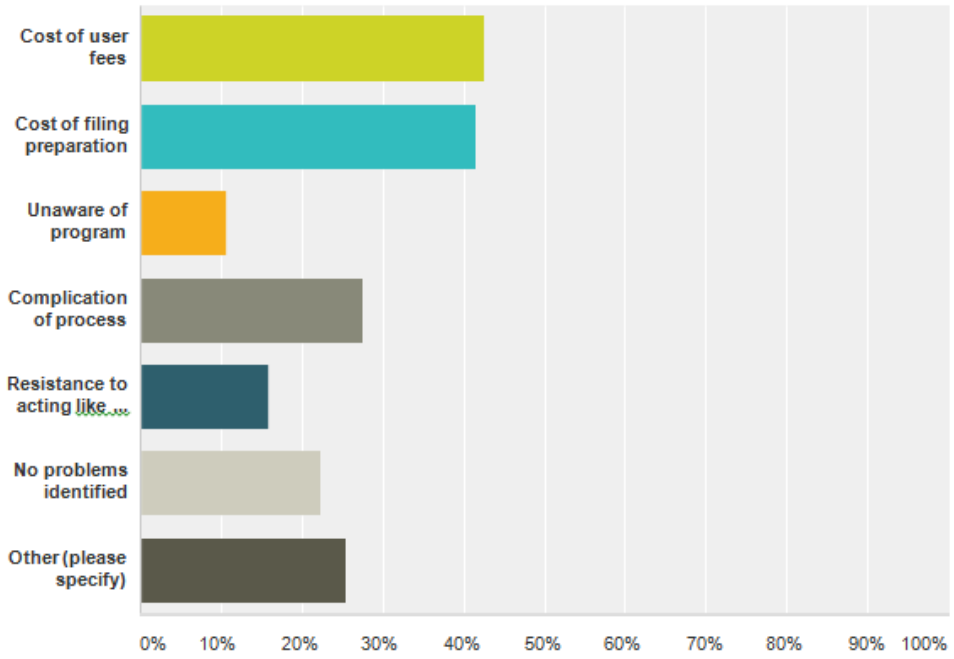
Answered: 101 Skipped: 64



Answer Choices	Responses	
Yes	**60.40%**	61
No	**39.60%**	40
Total		**101**

Q12 What are the main reasons why your 403(b) clients may not choose to file through VCP to fix their errors?

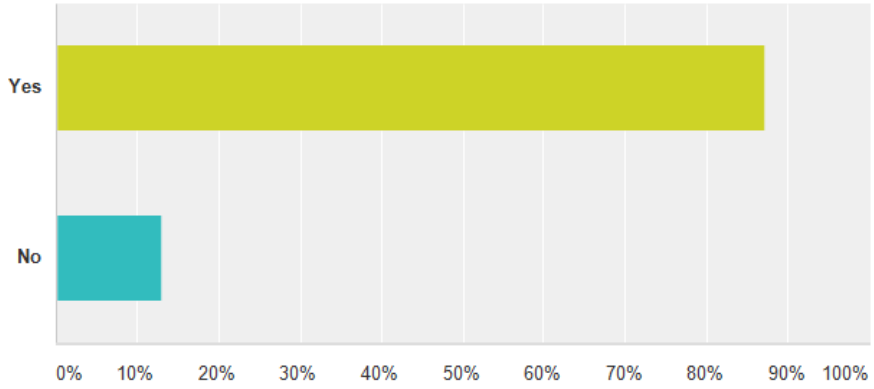
Answered: 94 Skipped: 71



Answer Choices	Responses	
Cost of user fees	**42.55%**	40
Cost of filing preparation	**41.49%**	39
Unaware of program	**10.64%**	10
Complication of process	**27.66%**	26
Resistance to acting like a fiduciary	**15.96%**	15
No problems identified	**22.34%**	21
Other (please specify)	**25.53%**	24
Total Respondents: 94		

Q13 Have you used any of the materials made available on the IRS website to support 403(b) plans?

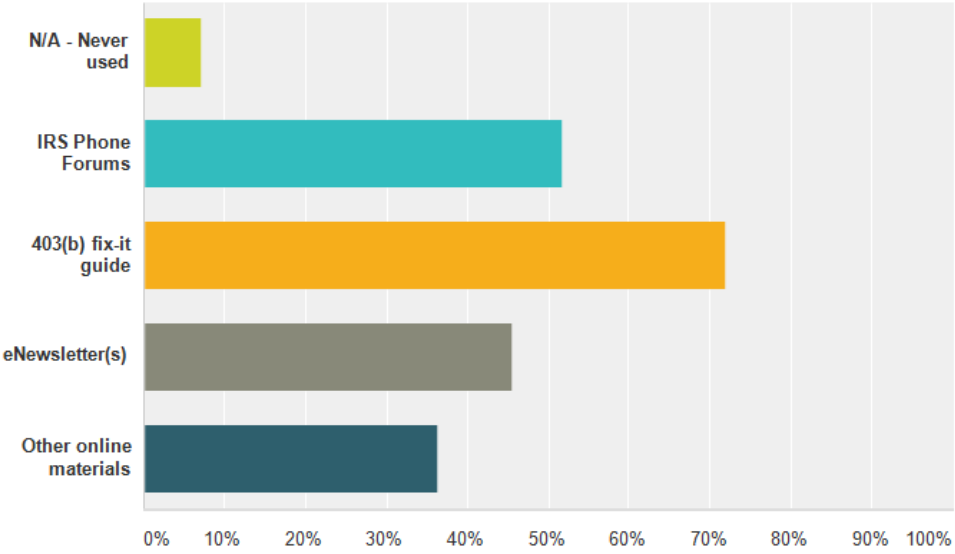
Answered: 100 Skipped: 65



Answer Choices	Responses	
Yes	**87.00%**	87
No	**13.00%**	13
Total		**100**

Q14 If you have used materials made available by the IRS, which resource did you find useful?

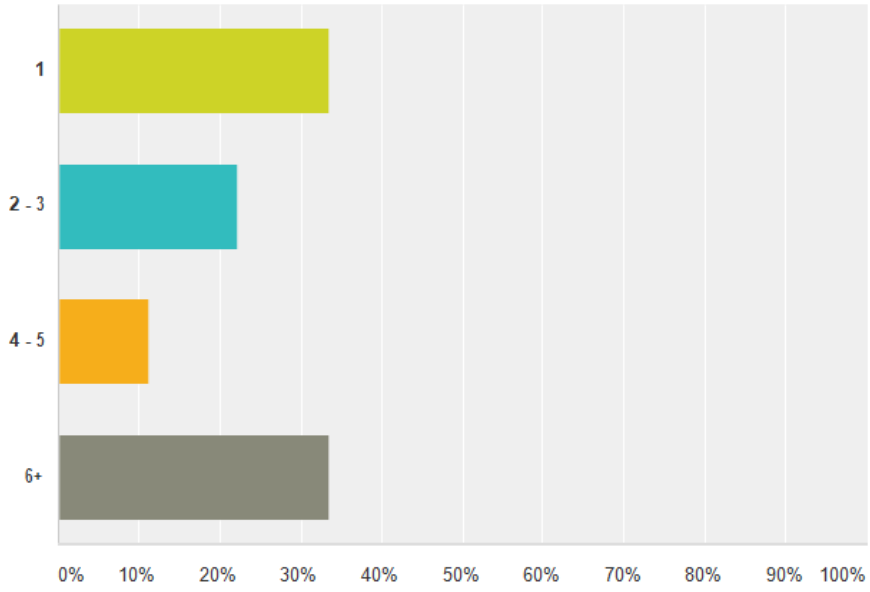
Answered: 99 Skipped: 66



Answer Choices	Responses	
N/A - Never used	**7.07%**	7
IRS Phone Forums	**51.52%**	51
403(b) fix-it guide	**71.72%**	71
eNewsletter(s)	**45.45%**	45
Other online materials	**36.36%**	36
Total Respondents: 99		

Q15 How many 403(b) annuity contracts or custodial accounts does your organization maintain?

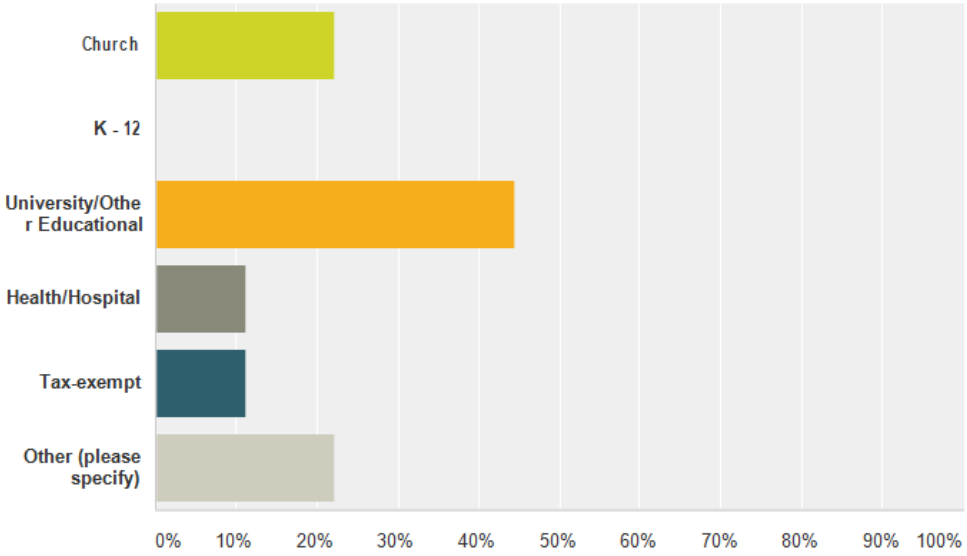
Answered: 9 Skipped: 156



Answer Choices	Responses	
1	**33.33%**	3
2 - 3	**22.22%**	2
4 - 5	**11.11%**	1
6+	**33.33%**	3
Total		**9**

Q16 What type(s) of entity is your organization?

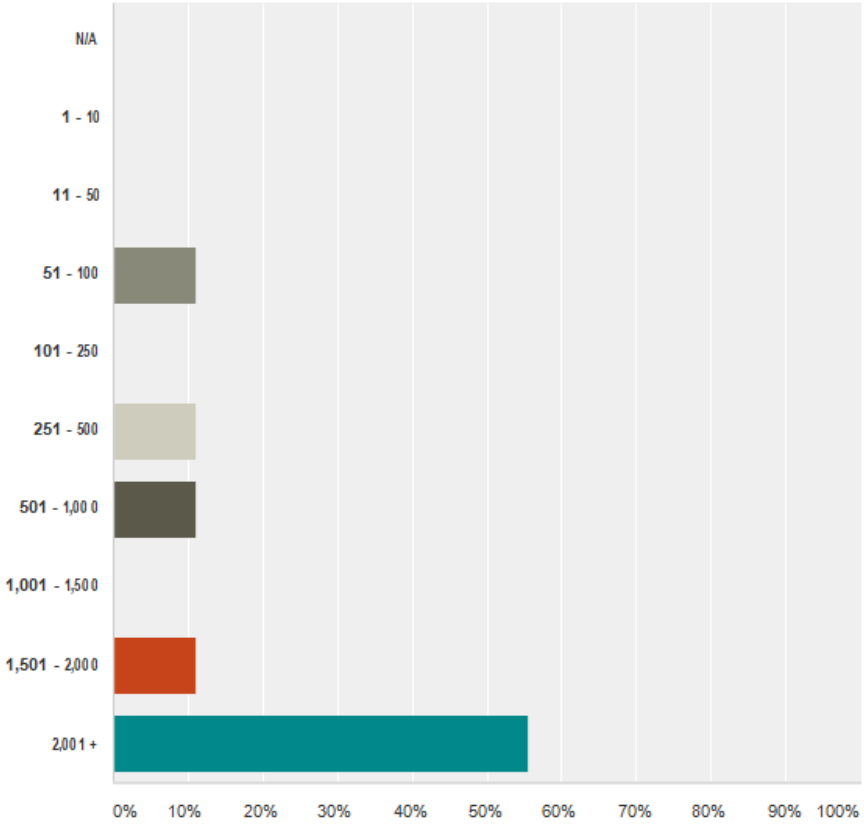
Answered: 9 Skipped: 156



Answer Choices	Responses	
Church	**22.22%**	2
K - 12	**0.00%**	0
University/Other Educational	**44.44%**	4
Health/Hospital	**11.11%**	1
Tax-exempt	**11.11%**	1
Other (please specify)	**22.22%**	2
Total Respondents: 9		

Q17 What is the total number of participants under your 403(b) arrangement(s)?

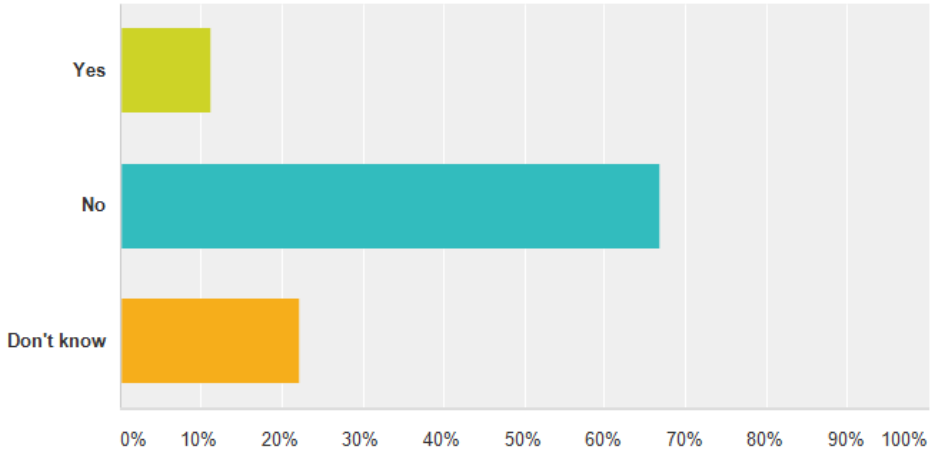
Answered: 9 Skipped: 156



Answer Choices	Responses	
N/A	**0.00%**	0
1 - 10	**0.00%**	0
11 - 50	**0.00%**	0
51 - 100	**11.11%**	1
101 - 250	**0.00%**	0
251 - 500	**11.11%**	1
501 - 1,000	**11.11%**	1
1,001 - 1,500	**0.00%**	0
1,501 - 2,000	**11.11%**	1
2,001+	**55.56%**	5
Total		**9**

Q18 Will you use an IRS approved 403(b) document once available?

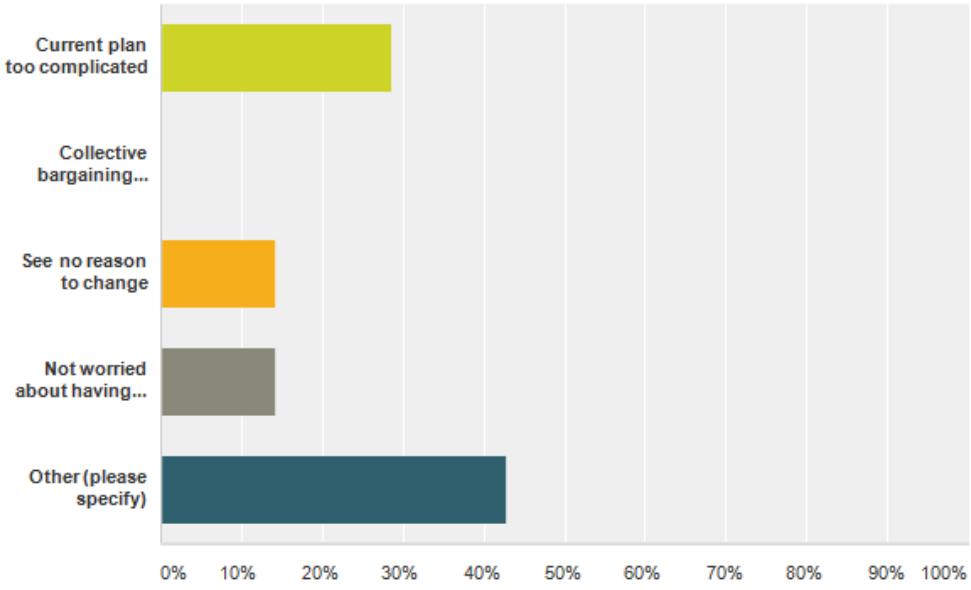
Answered: 9 Skipped: 156



Answer Choices	Responses	
Yes	**11.11%**	1
No	**66.67%**	6
Don't know	**22.22%**	2
Total		**9**

Q19 If you don't think that you will use a pre-approved 403(b) plan document, why not?

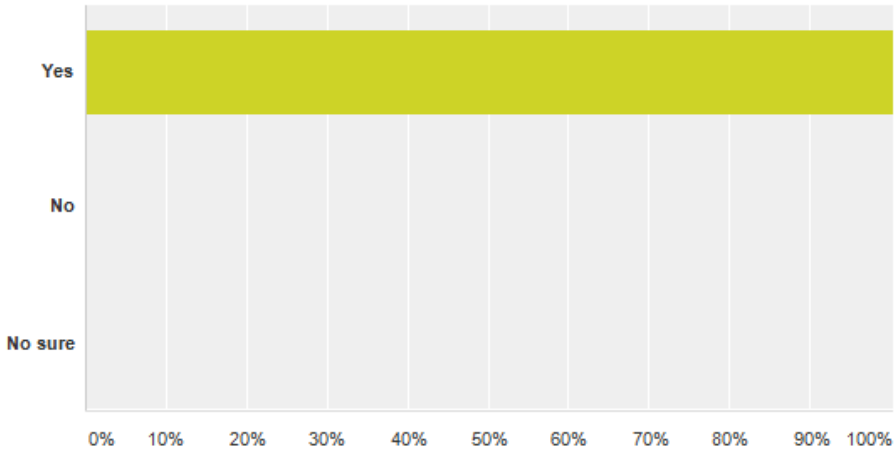
Answered: 7 Skipped: 158



Answer Choices	Responses	
Current plan too complicated	**28.57%**	2
Collective bargaining issues	**0.00%**	0
See no reason to change	**14.29%**	1
Not worried about having and IRS opinion letter	**14.29%**	1
Other (please specify)	**42.86%**	3
Total Respondents: 7		

Q20 Do you have a written 403(b) document?

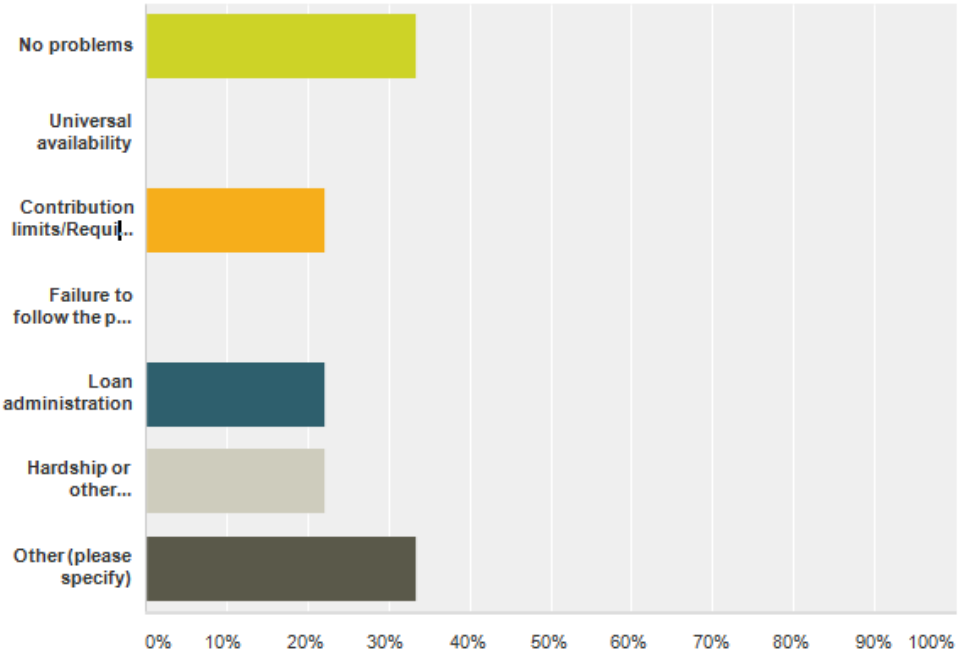
Answered: 9 Skipped: 156



Answer Choices	Responses	
Yes	**100.00%**	9
No	**0.00%**	0
No sure	**0.00%**	0
Total		**9**

Q21 What have been the main compliance problems that you have encountered under your 403(b) plan, if any?

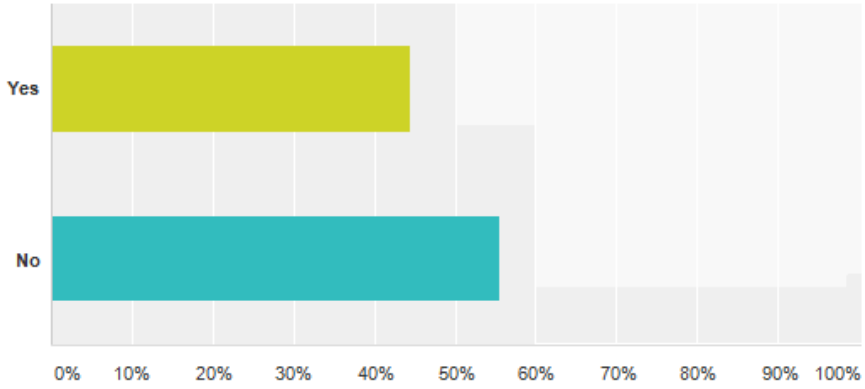
Answered: 9 Skipped: 156



Answer Choices	Responses	
No problems	**33.33%**	3
Universal availability	**0.00%**	0
Contribution limits/Requirements	**22.22%**	2
Failure to follow the plan document	**0.00%**	0
Loan administration	**22.22%**	2
Hardship or other in-service withdrawals	**22.22%**	2
Other (please specify)	**33.33%**	3
Total Respondents: 9		

Q22 Have you used the IRS's voluntary compliance program (VCP) to fix plan compliance errors?

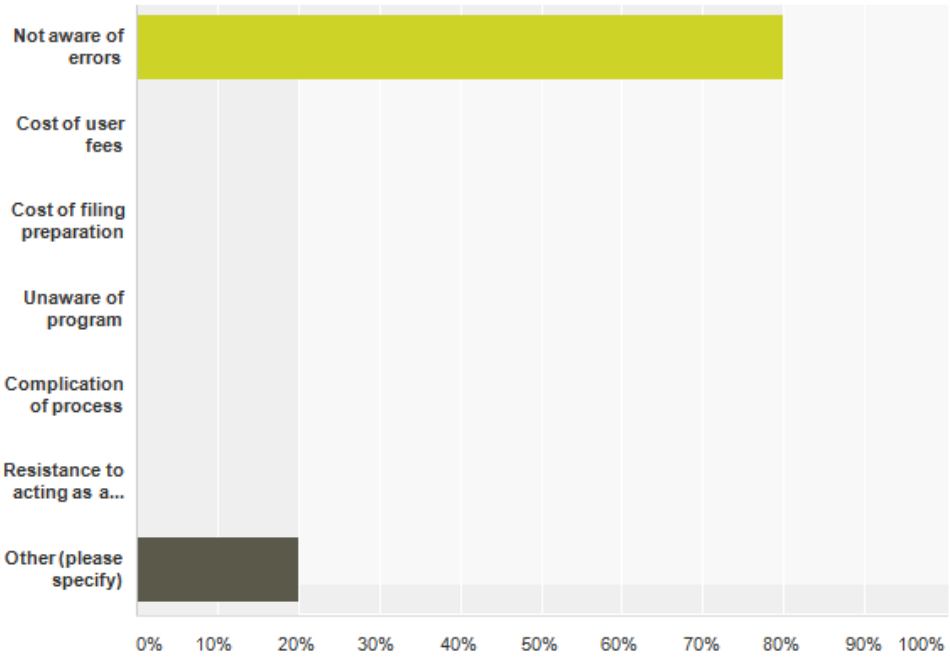
Answered: 9 Skipped: 156



Answer Choices	Responses	
Yes	**44.44%**	4
No	**55.56%**	5
Total		**9**

Q23 Why haven't you used VCP to fix errors?

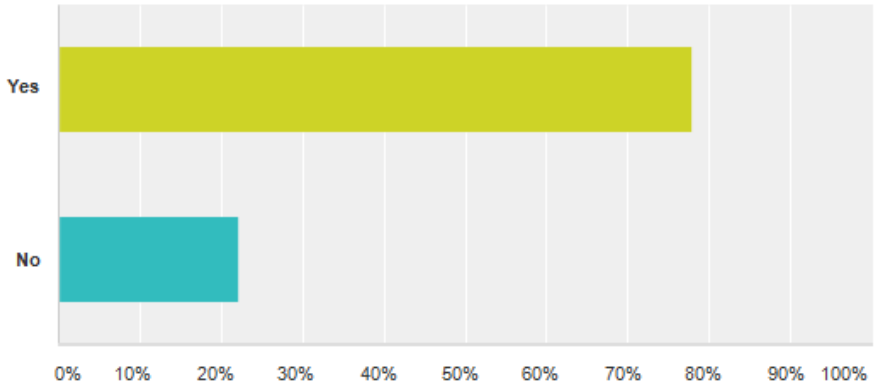
Answered: 5 Skipped: 160



Answer Choices	Responses	
Not aware of errors	**80.00%**	4
Cost of user fees	**0.00%**	0
Cost of filing preparation	**0.00%**	0
Unaware of program	**0.00%**	0
Complication of process	**0.00%**	0
Resistance to acting as a fiduciary	**0.00%**	0
Other (please specify)	**20.00%**	1
Total Respondents: 5		

Q24 Have you used any of the materials made available on the IRS website designed for 403(b) plans?

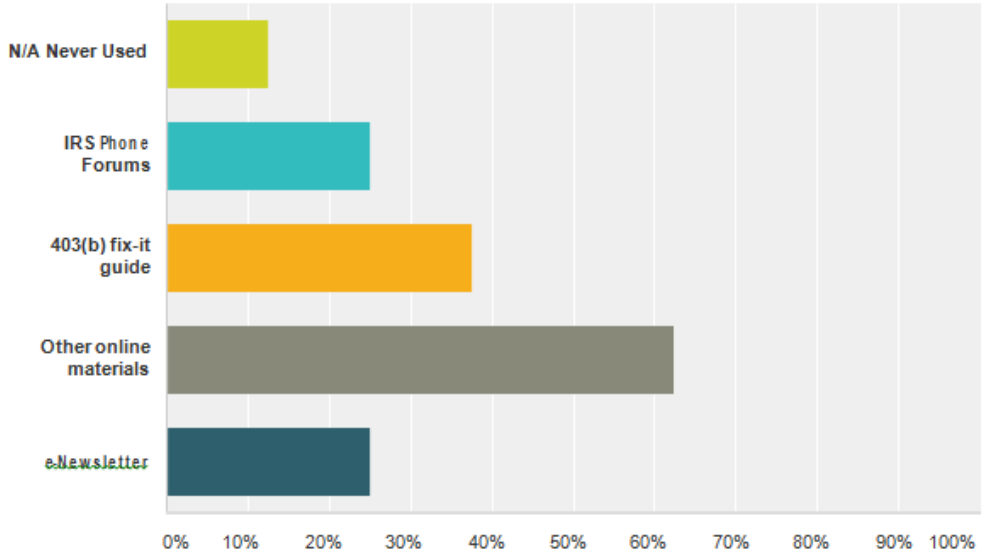
Answered: 9 Skipped: 156



Answer Choices	Responses	
Yes	**77.78%**	7
No	**22.22%**	2
Total		**9**

Q25 If you have used materials made available by the IRS, did you find any of the following IRS provided resources useful?

Answered: 8 Skipped: 157



Answer Choices	Responses	
N/A Never Used	**12.50%**	1
IRS Phone Forums	**25.00%**	2
403(b) fix-it guide	**37.50%**	3
Other online materials	**62.50%**	5
e-Newsletter	**25.00%**	2
Total Respondents: 8		

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Exempt Organizations:
The Redesigned Form 990: Recommendations for Improving its Effectiveness as a Reporting Tool and Source of Data for the Exempt Organization Community

Virginia C. Gross, Project Leader

Dave Moja, Project Leader

Amy Coates Madsen

Andrew Watt

Gary J. Young

June 17, 2015

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I. EXECUTIVE SUMMARY

For the 2008 filing year, the Internal Revenue Service (IRS) significantly redesigned the Form 990. This redesign represented a complete revamping of the information return that is filed by most types of tax-exempt organizations. The redesigned Form 990 was officially released on December 20, 2007, approximately six months after the IRS introduced a draft version of the form and solicited comments from the public.

IRS Commissioner Doug Shulman, in 2008, referred to the Form 990 redesign project as a “tremendous effort to bring the Form 990 up to date and to reflect the diversity and complexity of the tax-exempt community.” He further stated, "The revised form will give the IRS and the public a much better view of how exempt organizations operate. The improved transparency provided by these changes will also benefit the tax-exempt community.”

The report of the Exempt Organizations Subcommittee of the IRS Advisory Committee on Tax Exempt and Government Entities (the ACT) this year focuses on revisiting the Form 990 in light of several years of exempt organizations’ preparing, filing and effectively “living with” the new reporting and transparency provided by the enhanced Form 990 and 990-EZ, as well as the Form 990-N, which prior to 2007 was not required to be filed by smaller exempt organizations. The “new” Form 990 has undoubtedly impacted the manner in which exempt organizations report their information to the IRS and the level of public disclosure of an exempt organization’s activities and financial information. As with any significant change, however, there may be improvements that still can be made and frustrations that can be addressed with further adjustments.

The ACT surveyed users of the Form 990, including representatives of exempt organizations that file a Form 990, Form 990-EZ or Form 990-N, state and local government officials (charity officials and others), donors, advisors to donors, advisors to grant makers, practitioners (including attorneys and accountants), researchers, independent charity rating agencies, and IRS Exempt Organizations Division managers regarding their views on the information returns and the filing process. The ACT met with various nonprofit organizations industry groups to discuss Form 990 reporting and to fine-tune the ACT’s survey. The ACT reached out to these and other industry groups to distribute the survey to a wide sample of representatives from the exempt organizations community. While not a statistically valid sample, nearly 1900 individuals participated in the survey, which requested views on the Form 990 (along with the Form 990-EZ and 990-N, as applicable) and its effectiveness, electronic filing of the return, uses of the Form 990 and its data, and assistance with completion of the Form 990. The survey also gave participants the opportunity to provide additional comments regarding the information returns.

While the ACT was drafting this report, the United State Government Accountability Office (GAO) issued a report to the Ranking Member, Committee on Homeland Security and Governmental Affairs, U.S. Senate, titled "Tax-exempt Organizations: Better Compliance Indicators and Data, and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations," which focused on the IRS's oversight of charitable organizations. The GAO made two of recommendations to the IRS regarding its oversight activities which have been taken into account in preparing this report.

In addition, while the ACT was working on this report, the Northern District of California, in *Public.Resource.org v. United States Internal Revenue Service*, granted summary judgment to a charity seeking, pursuant to a Freedom of Information Act request, electronic copies of Forms 990 filed by exempt organization and ordered the IRS to produce nine requested Forms 990 in Modernized E-file (MeF) format to the charity within 60 days of the court's decision. Similar requests will require the IRS to become much more nimble in its ability to release information from exempt organization information returns in an electronic format to the public.

Our specific recommendations are as follows:

1. The IRS Exempt Organizations Division should encourage and support a Congressional mandate to require electronic filing of the Form 990 series and should also take interim steps to encourage and provide incentives for voluntary e-filing of the Form 990 series for exempt organizations that are not subject to the mandatory e-filing requirements. The IRS should recommend to the Department of Treasury the elimination of the $10 million asset threshold for electronic filing of the Form 990 found in the Internal Revenue Code Section 6011 regulations.

2. The IRS Exempt Organizations Division should convene a task force comprised of representative stakeholders to determine which parts and schedules of the current Form 990 and related instructions should be updated, enhanced, and/or deleted in order to allow a more clear understanding, better accuracy, enhanced consistency of reporting by the various Form 990 filers.

3. The IRS should consider requesting additional information from Form 990-N filers. This will be especially important given the relatively new Form 1023-EZ application process, which will result in more recognized tax-exempt organizations that will not have had their activities specifically reviewed by the IRS and which will likely file a Form 990-N due to their smaller size. In addition, because filing a Form 990-N likely will be the filing organization's only contact

with the IRS, the agency should engage in more education and outreach as part of the Form 990-N filing process.

II. INTRODUCTION

The Form 990, "Return of Organization Exempt from Income Tax," is the annual "information return" filed by more than half a million tax-exempt organizations. This form is unique in that it is subject to public disclosure and most of the information required to be reported to the IRS – including compensation of executives, amounts and demographics of grantees, and answers to questions about how the organization is governed – can be readily found and viewed on the internet by anyone, anywhere.

Although the Form 990 is filed with the IRS (and there are stiff penalties for filing a late, incomplete, and/or inaccurate return), the IRS is not the only "user" of Form 990 data. There are many reporters, comparers, and statisticians that map, accumulate, parse, average, and opine upon the information provided on the Form 990 by exempt organizations. In addition, staff, board members and other representatives of organizations that file a Form 990, development directors of exempt organizations, state charity officials, other state and local government officials, donors, grantors and investors to exempt organizations, advisors to donors and grantmakers, practitioners (e.g., attorneys, accountants), independent charity rating agencies, members of the press, and others make up the "990 Village" of filers and users of the Form 990 data.

The Form 990 is actually a series of information returns. The Form 990 is filed by organizations that generally have gross receipts at least equal to $200,000 or total assets at least equal to $500,000. The Form 990-EZ is filed by exempt organizations with gross receipts of less than $200,000 and total assets of less than $500,000. The Form 990-N – the "e-Postcard" – is an electronically-filed notification that requires limited information from exempt organizations whose annual revenues are normally less than or equal to $50,000. There is also a Form 990-PF, filed by private foundations. And, finally, to round out the 990-series, there is a Form 990-T on which exempt organizations that earn "unrelated business income" report those activities.[1]

In this report, we focus primarily upon the "new" Form 990, filed by 289,603 exempt organizations in 2013.[2] This form was completely overhauled for the 2008 filing year and, in 2015, we are still sorting out many of the requirements, nuances, and

[1] For more on Form 990-T and unrelated business activities, see "Analysis and Recommendations Regarding Unrelated Business Income Tax Compliance of Colleges and Universities, IRS Advisory Committee on Tax Exempt and Governmental Entities (June 11, 2014), available at http://www.irs.gov/Government-Entities/Reports-of-the-Advisory-Committee-on-Tax-Exempt-and-Government-Entities-%28ACT%29.

[2] Annual EO Financial Extracts, available at http://www.irs.gov/uac/SOI-Tax-Stats-Annual-Extract-of-Tax-Exempt-Organization-Financial-Data.

presentations of data required by the IRS in its instructions and other Form 990 guidance.

The current Form 990 is a twelve-page IRS return (for 2014) with sixteen "supplemental schedules." Most exempt organizations may file only five or six of these schedules, but gathering the data, deciphering the instructions, and completing the form and schedules can be grueling. From 1979 to 2008, Form 990 had received only minor, piecemeal updates. In redesigning the Form 990 (a process in which the ACT participated significantly) the IRS' stated goals were as follows:

- Enhancing transparency to provide the IRS and the public with a realistic picture of the organization
- Promoting compliance by accurately reflecting the organization's operations so the IRS may efficiently assess the risk of noncompliance
- Minimize the burden on filing organizations

In the course of developing the 2015 Exempt Organizations Subcommittee ACT Report, we estimate that we sent, via distribution networks, access to a questionnaire to more than 148,000 users of the Form 990 and received nearly 1,900 responses. Prior to developing the questionnaire, we conducted in-person and conference call "roundtables" with various stakeholder groups (these groups are set forth on **Appendix A**). During these roundtables discussions, we saw several "themes" developing regarding the Form 990 and its data: (a) vast support for e-filing and open data for the sector, (b) a desire for increased breakdown on contributions, government grants, governmental contract income and other forms of support, (c) coordination with state charity officials on their data needs, and (d) the incorporation/inclusion of meaningful "NTEE-type"[3] codes.

The various Form 990 users need and want more information from the data collected and reported on Form 990 and the IRS itself appears to be underutilizing the electronic data that it is receiving from tax-exempt organizations. They also want more clarity and consistency with respect to Form 990 reporting. Due to budgetary limitations, the IRS can only transcribe certain data from paper-filed returns and these restrictions are also applied to e-filed Form 990 data. The IRS utilizes input from numerous groups to annually propose modifications/improvements to Form 990. We believe that the survey data we have collected and report upon herein will allow the IRS to listen to a broader population of the various Form 990 users and hear what they are saying about needed changes, clarity, and guidance. Hopefully, this will allow the IRS to take responsibility for

[3] NTEE is the abbreviation for National Taxonomy of Exempt Entities. See http://nccs.urban.org/classification/NTEE.cfm.

making changes to the form, instructions, data, and content in a manner that makes life in the "990 Village" more effective, efficient, enforceable, and – nay we say it – peaceful.

III. THE FORM 990 AND ELECTRONIC FILING REQUIREMENTS

A. The Form 990 Filing Requirement and Redesign of the Form 990

The Revenue Act of 1943 created the first requirement for tax-exempt organizations to file an annual information return. The use of the term "information return" is not coincidental, as the information return filed by exempt organizations is much more than just a tax return, with a host of questions and schedules designed to provide the IRS and the public with information on the organization's programs, governance, officers and directors, compensation, related parties, and grant-making activities. The annual information return requirement is currently embodied in Section 6033 of the Internal Revenue Code of 1986, as amended (the "Code"),[4] which requires that every organization exempt from taxation under Section 501(a) must, unless an exception applies (see below), file an annual information return "stating specifically the items of gross income, receipts, and disbursements, and such other information for the purposes of carrying out the internal revenue laws" as the IRS may by forms or regulations prescribe.

The forms that most tax-exempt organizations must use to comply with the annual information return requirement are the Form 990 (Return of Organization Exempt from Income Tax), Form 990-EZ (Short Form Return of Organization Exempt from Income Tax) or (more recently) Form 990-N (e-Postcard). Certain tax-exempt organizations are subject to special return filing requirements. Private foundations submit their information to the IRS on a Form 990-PF (Return of Private Foundation). Black lung benefit trusts described in Section 501(c)(21) use Form 990-BL (Information and Initial Excise Tax Return for Black Lung Trusts and Certain Related Persons), religious or apostolic organizations described in Section 501(d) use Form 1065 (U.S. Return of Partnership Income) and stock bonus, pension, or profit-sharing trusts qualifying under Section 401 use Form 5500 (Annual Return/Report of Employee Benefit Plan). Exempt organizations separately report their unrelated business income on a Form 990-T (Exempt Organization Business Income Tax Return).

Many exempt organizations are excepted from these filing requirements, including churches, their integrated auxiliaries, conventions of associations of churches, and the exclusively religious activities of a religious order.[5] State institutions (including state colleges and universities), instrumentalities of United States, and schools affiliated with

[4] All Section references herein are to the Code, unless otherwise noted.
[5] Code Section 6033(a)(3)(A).

a church or operated by a religious order are not subject to the Form 990 filing requirements.[6] Organizations that are part of a group exemption and included on a group return filed by the central or parent organization do not have to separately file a Form 990.[7] The IRS also has the discretion under Section 6033(a)(3)(B) to relieve additional organizations from the Form 990 filing requirements where it determines the filing is not necessary to the efficient administration of the internal revenue laws, which it has done, for example, for government units and affiliates of governmental units.[8]

Of the 1,052,495 active Section 501(c)(3) organizations in 2013, approximately 38.1 percent filed a Form 990 or 990-EZ in 2013.[9] Certain Section 501(c)(3) charitable organizations are not required to file a Form 990, including churches, other religious organizations, and smaller exempt organizations qualifying for the Form 990-N filing. In addition, private foundations, which are also Section 501(c)(3) charitable organizations, file a Form 990-PF.

1. Type of Form 990 to be filed

Which type of Form 990 a filing organization must file is determined, in part, by the size of its gross receipts and assets? The current Form 990 financial thresholds are:

Gross Receipts	Form Required
Gross receipts normally less than or equal to $50,000	Form 990-N
Gross receipts less than $200,000 and total assets less than $500,000	Form 990-EZ
Gross receipts equal to or greater than $200,000 or total assets equal to or greater than $500,000	Form 990

These thresholds were phased in over time, with the current levels in place beginning with the 2010 filing year.[10] Which Form 990 an organization is allowed to file also

[6] Treasury Regulation §1.6033-2(g).
[7] Treasury Regulation §1.6033-2(d). The ACT examined the group exemption procedures in its report for 2011. The ACT recommended that group exemptions be retained but also recommended several reforms to the procedures including the elimination of group returns by amending Treasury Regulations section 1.6033-2(d) to remove the authority of central organizations to file group returns. *See*, "Exempt Organizations: Group Exemptions – Creating a Higher Degree of Transparency, Accountability, and Responsibility" (June 15, 2011).
[8] Revenue Procedure 95-48, 1995-2 C.B. 418.
[9] Of these filers, 223,810 filed a Form 990 and 177,781 filed a Form 990-EZ. http://www.irs.gov/uac/SOI-Tax-Stats-IRS-Data-Book.
[10] The ACT examined the filing thresholds for 990-EZ filing in its report for 2013. The ACT recommended retaining the current thresholds but also recommended that 990-EZ filers be required to report additional

depends upon the type of tax-exempt organization the entity is, as certain organizations are not allowed to file a Form 990-N or 990-EZ. For example, except in certain instances, supporting organizations may not file a Form 990-N and organizations sponsoring donor-advised funds may not use either the Form 990-N or 990-EZ. A controlling organization of one or more controlled entities for which there was a certain type of transfer of funds between the controlling organization and any controlled entity during the year must file a Form 990. So, too, must organizations operating one or more hospital facilities. A parent organization filing a group return on behalf of its subordinates also must use a Form 990. Tax-exempt political organizations typically must file a Form 990 or 990-EZ unless they meet certain exceptions.

2. 990-N the "electronic postcard" filing

Prior to the enactment of the Pension Protection Act of 2006 (PPA), certain small organizations (generally, with gross receipts of $25,000 or less) were not required to file a Form 990 or 990-EZ. The PPA amended Code Section 6033 to require electronic filing of a notification for these smaller tax-exempt organizations (the gross receipts threshold has since increased to no more than $50,000). Under Code Section 6033(i), these smaller tax-exempt organizations must provide the following information to the IRS electronically, using the Form 990-N (also referred to as the e-Postcard):[11]

- the organization's legal name,
- the name under which it operates or does business,
- its mailing address,
- website address,
- taxpayer identification number,
- name and address of its principal officers, and
- evidence of the continuing basis for the organization's exemption from the filing requirements.

The number of organizations filing a Form 990-N appears to be steadily increasing. For calendar year 2012, 475,473 organizations filed a Form 990-N, compared to 489,372 for calendar year 2013 and 531,310 for calendar year 2014.[12]

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information through various additional schedules. *See*, "Exempt Organizations: Leveraging Limited IRS Resources in the Administration of Small Tax-Exempt Organizations" (September 12, 2013).

[11] Note, these organizations may instead file a Form 990 or 990-EZ to satisfy their filing requirements.

[12] Written information received from the IRS (April 13, 2015).

3. Revocation of Exempt Status for Failure to File the Form 990

The PPA amended the Code to provide that an organization failing to file an annual information return or notice for three consecutive years automatically loses its tax-exempt status as of the due date of the third annual return or notice.[13] If an organization's exempt status is revoked under this provision, it must apply to have its status reinstated regardless of whether the organization was originally required to apply for recognition of exempt status.[14] If the organization can demonstrate reasonable cause for its failure to file, the IRS has the discretion to reinstate its exempt status retroactively.[15] It has been estimated that approximately 594,000 organizations lost their tax-exempt status for failing to file Forms 990. Many of these organizations, however, were not operational. Approximately 11 percent (68,000) of these organizations reapplied and have had their tax-exempt status reinstated.

4. The Redesigned Form 990

The redesigned Form 990 first appeared as a discussion draft in June, 2007. To say that the Form 990 was revised would be a massive understatement. The Form 990 was revamped, overhauled, enlarged, and transformed into a much more comprehensive and narrative-based version of its former self. In the redesign, the Form 990 grew from nine pages and two schedules to 11 pages and 16 schedules. The June 2007 Form 990 discussion draft was followed by a 90-day comment period during which the IRS received nearly 700 emails and letters providing public comments on the draft.

A final version of the Form 990 was released on December 20, 2007 with instructions released in 2008. The final version of the Form 990 reflected many of the public comments received, such as allowing an organization to describe its exempt accomplishments and mission up front and providing more opportunities throughout the form for the organization to explain its activities. The IRS also added Schedule O to the Form 990 in response to public comments requesting more opportunity to provide explanations and narrative responses to the form's questions. The final version of the Form 990 addressed privacy and security concerns expressed by the nonprofit sector regarding reporting of officer and director compensation and persons working abroad in unsafe foreign areas. Other major changes were made to the form's summary page, governance section, and various schedules, including those relating to related organizations, hospitals, non-cash contributions and tax exempt bonds. A checklist of schedules was also added to the final version of the redesigned Form 990.

[13] Code Section 6033(j)(1).
[14] Code Section 6033(j)(2).
[15] Code Section 6033(j)(3).

The redesigned Form 990 was first used for the 2008 filing year, with a phase-in of the current gross receipts and asset size filing thresholds. Full reporting on Schedule H (Hospitals) and Schedule K (Tax-exempt Bonds) was phased in over time.

The core of the Form 990 requests information on the following:

1. Basic facts about the filer
2. The types of programs the filer offers and the amounts spent on them.
3. The filer's board members, the organization's governance structure, and whether the filer changed in any significant way during the year
4. The filer's income and sources of support.
5. The filer's expenses.
6. The amount paid to the filer's top earners and salary information on these earners.
7. Information on net assets.
8. Information on transactions with insiders and information on excess benefit transactions during the year.
9. The tax-exempt status of the filer.
10. Information on the filer's lobbying activities[16]

B. Advent of Electronic Filing of the Form 990 for Large Organizations

Code Section 6011(e) authorizes the Secretary of the Treasury to prescribe regulations providing for standards for the e-filing of returns. The Secretary is not allowed to require any taxpayer to file a return electronically unless the taxpayer is required to file at least 250 returns during a calendar year.[17] The Secretary is also instructed to take into account the ability of the taxpayer to comply with the reasonable cost of e-filing[18] and is further authorized to implement procedures to provide for "the payment of appropriate incentives for electronically filed returns."[19]

The regulations that were promulgated under Code Section 6011 in 2005 narrow the category of exempt organizations that are required to file a Form 990 electronically by

[16] See, P. Swords, "How to Read the New IRS Form 990," Nonprofit Coordinating Committee of New York, Inc. (2011), available at www.npccny.org/new990/new990.htm.
[17] Code Section 6011(e)(2)(A).
[18] Code Section 6011(e)(2)(B).
[19] Code Section 6011(f).

adding an additional $10 million asset threshold; that is, an exempt organization must file its Form 990 electronically only if it is required to file at least 250 returns in a calendar year and has total assets exceeding $10 million.[20] For purpose of the 250-return requirement, returns of any type are counted, including information returns, income tax returns, employment tax returns and excise tax returns.[21] For example, an exempt organization with more than $10 million in total assets filing a Form 990, 200 Forms W-2, four Forms 941, one Form 940, and 60 Forms 1099-MISC (a total of 266 returns) is required to electronically file its Form 990.[22] Private foundations, unlike public charities, are subject only to the 250 returns threshold. Once this threshold is met, a private foundation must electronically file a Form 990-PF regardless of asset size. The preamble to these regulations states that exclusion of certain exempt organizations with total assets of less than $10 million was to "eliminate the potential burden of electronic filing on small business that may not be able to comply at a reasonable cost."[23] In promulgating the regulations, however, the Department of Treasury encouraged all organizations to adopt electronic filing as soon as feasible even if not required by the regulations to do so.

The Internal Revenue Service Restructuring and Reform Act of 1998 states that it is the policy of Congress that "paperless filing should be the preferred and most convenient means of filing federal tax and information returns." The 1998 Act further set a goal for the IRS to have at least 80 percent of all federal tax and information returns filed electronically by 2007. In 2014, approximately 48 percent of exempt organization returns other than the Form 990-N were e-filed, with 60.10 percent of the Forms 990 electronically filed, 37.63 percent of the Forms 990-EZ electronically filed, and 41.15 percent of the Forms 990-PF electronically filed.[24]

Any organization may file its Form 990 and related forms, schedules, and attachments electronically. Under section 6652(c)(1)(A), a penalty of $20 a day, not to exceed the lesser of $10,000 or 5% of the gross receipts of the organization for the year, can be charged when a return is filed late, unless the organization shows that the late filing was due to reasonable cause.[25] Organizations with gross receipts over one million dollars for the filing year, however, face higher penalties under Section 6652 for filing a late, inaccurate, or incomplete return than other exempt organizations. These penalties are $100 per day, up to a $50,000 maximum. If an organization is required to file a return

[20] Treasury Regulation §301.6033-4(f). The $10 million asset threshold became effective for tax years ending on or after December 31, 2006. "Total assets" is defined in the Form 990 instructions glossary as "[t]he amount reported on Form 990, Part X, line 16, column (B)."
[21] Treasury Regulation §301.6033-4(d)(3).
[22] Treasury Regulation §301.6033-4(e).
[23] T.D. 9175 (January 12, 2005).
[24] Information provided to the ACT by the IRS.
[25] 2014 Form 990 Instructions, page 6

electronically but does not, the organization is considered not to have filed its return, even if a paper return is submitted.[26] The exception to this e-filing requirement is when a larger organization is reporting a name change, in which case it must file its Form 990 on paper and attach the required documents.

At the time of this report, only the very largest exempt organizations, both by asset size and number of employees, are required to electronically file the Form 990. As previously discussed, large organizations with assets of more than $10 million and which are required to file more than 250 returns during the year must e-file the Form 990. The very smallest exempt organizations are subject to an electronic filing requirement, as the Form 990-N must be filed online, although these organizations have the option of filing, either electronically or on paper, a Form 990 or Form d990-EZ. Other exempt organizations filing a Form 990 may choose, but are not required, to electronically file.

C. Form 990-N Filers and the Form 1023-EZ

In 2014, the IRS unveiled the new Form 1023-EZ, which is a streamlined application process for the review of organizations seeking to obtain recognition of tax-exempt status under Section 501(c)(3). The Form 1023-EZ streamlined process was in response to the IRS's tremendous backlog of Form 1023 applications, due in large part to applications for reinstatement filed as a result of the auto-revocation provision enacted as part of the PPA.

The Form 1023-EZ application process is available only to smaller nonprofit organizations with anticipated gross receipts of no more than $50,000 for the past three years and which are not projected to exceed this amount for the next three years. In addition, an organization must have total assets that do not exceed $250,000. In addition, the EZ process is unavailable to many types of tax-exempt organizations such as hospitals, schools, supporting organizations, private operating foundations, and limited liability companies. The Form 1023-EZ requests only cursory information from the filing organization, relying heavily on attestations and self-reporting from the organization that it complies with the various requirements of the particular tax-exempt status for which it is seeking recognition. The Form 1023-EZ process has done much to reduce the backlog of pending IRS applications for recognition of exemption.

The Form 1023-EZ received a significant amount of criticism from the nonprofit community. Many grantmakers, state charity officials and others were critical of the IRS taking only a cursory review of a new organization's purposes and activities. For compliance purposes, the IRS selects a statistically valid, random sample (three percent) of the Form 1023-EZ applications filed for a pre-determination review to

[26] *Id.*, p. 6. See also, Treasury Regulation §301.6033-4(c).

request additional information to ensure they qualify for the EZ processing. The IRS asks these randomly selected organizations five questions, including information about gross receipts, assets, basis for exemption, copies of articles of incorporation and bylaws, and whether the organization has any transactions with related parties.[27]

In addition, the IRS has stated that it will be conducting enhanced compliance reviews of these organizations in later years as their operations continue. More specifically, EO will be implementing a post-determination compliance program for Form 1023-EZ filers in 2016. This program will consist of correspondence examinations on a random sample of the information returns (Form 990 series, including the 990-N) filed by organizations which obtained recognition of exempt status through the filing of a Form 1023-EZ. This compliance program will allow EO to determine the exemption compliance of newly exempt small organizations after they have been in operation for a year or more. EO will use the findings from this post-determination compliance program to identify opportunities for further improvement and adjustments to the Form 1023-EZ as well as to EO's application processing.[28]

Because the gross receipts limitation for filing the Form 1023-EZ is the same as for filing a Form 990-N, many of the organizations qualifying for the Form 1023-EZ process will be eligible to file a Form 990-N for their first several years of operation, if not longer.

D. Availability and Use of Internet Services

Internet use has increased substantially over the past 20 years. According to the U.S. Census Bureau, 54.7 percent of U.S. households in 2003 had internet use at home,[29] while 74.4 percent of U.S. households in 2013 reported internet use using an internet subscription and 73.4 percent of households reporting a high-speed connection.[30] For the increase in household computer and internet use from 1984 – 2011, see **Appendix C.** This only accounts for household internet availability; it does not include access to internet use in public places, such as a public library. In studying internet use, the Pew Research Center found that in 1995, only 14 percent of American adults used the internet. The study determined that in 2005, 66 percent of Americans adults used the Internet, and in 2014, the percentage grew to 87 percent of Americans adults using the Internet.

[27] Rev. Proc. 2015-5, 2015-1 I.R.B. 186, Section 5.03. Also, Comments of Sunita Lough, Commissioner of Tax Exempt and Government Entities, as delivered to attendees at the annual joint meeting of the TEGE Councils on February 27, 2015, reported in the EO Tax Journal (March 13, 2015).
[28] Written information received from Tamera Ripperda, Exempt Organizations Director (April 3, 2015).
[29] T. File, "Computer and Internet Use in the United States," published by the United States Census Bureau (May 2013).
[30] T. File and C. Ryan, "Computer and Internet Use in the United States: 2013," published by the United States Census Bureau (November 2014).

Internet access even in 2015, however, remains an issue for a portion of Americans and the organizations they represent. Access to affordable and reliable internet service in some remote, rural and mountain areas can be problematic. For example, some nonprofit organizations in rural Alaska may be headquartered over 100 miles from the nearest public library and not otherwise have access to internet services.[31]

E. Users of the Form 990

Federal and state regulators, and various segments of the general public each use Form 990 for different – though complementary – purposes.

1. Government

a. Federal agencies. The primary purpose of Form 990 is enforcement of federal tax law and to meet the statutory information return requirement for tax-exempt organizations. The form generates information that the IRS may use to assess whether the filing organization continues to comply with the requirements for tax-exempt status. It provides the IRS with information that may trigger an audit or other contact with a filing organization.[32]

The IRS Research Analysis and Statistics (RAS) Division maintains a database with images of the Forms 990 as they are received. Paper returns are scanned, while data from electronic filings are 'rendered' into images. The unredacted images are used internally for research purposes. The images also undergo a redaction process (which removes information that does not have to be made available to the public) and are made available to the public.

The Statistics of Income (SOI) Division of IRS, which is a part of RAS, uses data from both the paper returns and electronic filings to select, on a weekly basis, stratified data samples for published Form 990 series studies.[33] SOI performs data analysis and develops datasets made available to the public on www.IRS.gov under TaxStats. Datasets from SOI are used for research and estimation work by the IRS, the Department of Treasury, and the Congress.[34]

[31] In 2013, approximately 21,000 households in Alaska were not served by broadband and more than half the country's institutions such as hospitals, libraries, and government entities with insufficient broadband capabilities were located in Alaska. "A Blueprint for Alaska's Broadband Future," a Report from the Statewide Broadband Task Force, p.4 (August 2013).
[32] "Policies and Guidelines for Form 990 Revision," Advisory Committee on Tax Exempt and Government Entities (June 7, 2006), p. 14.
[33] B. Noveck and D. Goroff, "Information for Impact: Liberating Nonprofit Sector Data," 2nd ed., The Aspen Institute (2013), p. 14.
[34] Id., p. 16.

b. State Charity and Other State Officials use Form 990 data primarily for issues of governance, charitable purpose, and fundraising regulation. Even in states that require separate applications for recognition of tax-exempt status, state regulators generally direct their attention to improving the behavior of those governing charities and to the detection and prevention of solicitation fraud involving charities. Disclosure of joint cost allocations for fundraising activities, for example, enables state charity regulators to identify organizations that may not be in compliance with state charitable solicitation laws. Information about compensation and insider transactions may signal a diversion of charitable assets away from charitable purposes which state regulators are obligated by state law to enforce.[35]

Most states require a copy of the Form 990 only from exempt organizations that solicit funds in their state. Some states require additional information from charities. For example, New Hampshire and Florida require charities to submit evidence each year that they have re-certified their conflict of interest policy, while California requires both a tax form and a separate report to the Registry of Charitable Trusts within the Department of Justice.[36] Most states require annual renewal forms from entities that are soliciting contributions in the state in addition to a copy of the Form 990. State charity officials are currently working on a single portal initiative that will allow nonprofits to register on one multistate registration site that will allow nonprofit organizations and their professional fundraisers to comply with the participating states' registration and annual filing requirements, referred to as the "The Single Portal Multistate Charities Registration Initiative." At the time of this report, twelve states (Alaska, California, Colorado, Connecticut, Hawaii, Illinois, Massachusetts, Michigan, Mississippi, Missouri, New Hampshire and Tennessee) have joined together in a pilot project to build and launch the single portal website. This initiative may provide an opportunity to work more closely with the IRS on collection of basic data about nonprofit organizations.[37]

Sections 6103 and 6104 set forth the rules for the IRS's sharing of return information with state officials. Section 6104(c) allows the IRS to share certain information on charitable organizations with state charity regulators such as revenue agents' reports on proposed revocations of tax-exempt status and notices of deficiencies. However, state officials are subject to strict procedures to safeguard the confidentiality of taxpayer data. The lack of clarity surrounding how states can use data from the IRS to build their own cases, and the criminal penalties attached to improper disclosure of the data, have

[35] "Policies and Guidelines for Form 990 Revision, Advisory Committee on Tax Exempt and Government Entities (June 7, 2006), op. cit.
[36] *Id*, p. 15.
[37] Conference call with Tom Pollak from the National Center for Charitable Statistics, November 14, 2014, and written information received from Janet M. Kleinfelter, Deputy Attorney General, Public Interest Division
Office of Tennessee Attorney General (March 20, 2015).

prevented most state charity regulators from incorporating IRS data in their investigations.[38]

2. Other Users

Because the Form 990 includes questions about a tax-exempt organization's mission, exempt activities, officers' compensation, governance, finances, and investments, the data the form collects are of interest to academics, independent organizations that provide services to the sector, nonprofits themselves, the media, and the general public, including donors and potential donors. Uses of the data include identification of trends in the sector, development of products and services to help improve nonprofits, and research on particular exempt organizations by donors and potential donors.

a. Researchers and entrepreneurs. Private sector organizations use Form 990 data for both research and entrepreneurial purposes. In some cases they make data available for free, and in others they charge a fee to allow others to use the data and tools they've developed for using the data.

- GuideStar extracts Form 990 data from IRS image files and makes the digitized, searchable images available to IRS, researchers, nonprofits, and the public. Nonprofits can update their organization's profile with additional information about their activities. In conjunction with BBB Wise Giving Alliance and Independent Sector, GuideStar offers a "Charting Impact" tool that can help a nonprofit tell its story, including its goals and progress in achieving them. In addition, GuideStar also provides additional services through a range of data sets and supplemental products.
- The Foundation Center uses IRS data in developing its database of grant information on private foundations for use by grant seekers and researchers. In addition to providing information on grantors and grant recipients, it provides links to copies of multiple years of Form 990 and 990-PF. The forms are searchable through a tool called 990 Finder. The Center also conducts research on trends in grantmaking for the nonprofit sector.
- The National Center for Charitable Statistics (NCCS), a part of the National Center on Nonprofits and Philanthropy (NCNP) at the Urban Institute, cross-checks SOI data samples against published data files from IRS, fixes inconsistencies where it can, and adds classification codes. NCCS also

[38] "Tax-exempt Organizations: Better Compliance Indicators and Data, and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations," a report to the Ranking Member, Committee on Homeland Security and Governmental Affairs, U.S. Senate, U.S. Government Accountability Office (December 2014), p.38. See also "Exempt Organizations: Leveraging Limited IRS Resources in the Tax Administration of Small Tax-Exempt Organizations," IRS Advisory Committee on Tax Exempt and Governmental Entities (2013).

keypunches several thousand Form 990 results each year to capture supplemental information such as organization purposes and programs and more detail on revenues, expenses, assets and liabilities, and governance. These data are made available on the web for use by the general public through the easy to use Table Wizard/Report Builder, and to the research community through the more sophisticated DataWeb. The NCCS Community Platform Project combines IRS data with census and other data and collaboration tools in a website for use by state and local partners including foundations, United Ways, universities, and governments. The Center produces publications such as *The Nonprofit Sector in Brief* and reports on special topics, and provides online tools nonprofits can use to complete their Forms 990 and 990-EZ and file them electronically with the IRS.

- Other websites and organizations work with Form 990 data in providing services to the sector. Examples include GiveSmart, Charity Navigator, GiveWell, Great Nonprofits, and Charity Blossom.
- Financial services firms seeking potential customers may use 990 data.
- Compensation consultants use information available on Form 990 for comparability data to determine the reasonableness of compensation of organizations' officers, key employees and independent contractors.

b. Media representatives. Reporters use Form 990 information for stories on charitable giving, nonprofit governance, and other activities of exempt organizations.[39]

c. The general public, including donors, potential donors and grantmakers to charitable organizations, use data from the 990 to learn about the nonprofit sector and/or about particular organizations in the sector. IRS provides a search tool, Exempt Organizations Select Check, that allows users to check on an exempt Section 501(c)(3) organization's designated federal tax-exempt status. Searches can be made by EIN, name or location of the organization. The site consolidates three former search sites into one, providing expanded search capability and a more efficient way to search for organizations that:

- Are eligible to receive tax-deductible charitable contributions. Users may rely on this list in determining the deductibility of their contributions.
- Have had their tax-exempt status automatically revoked under the law because they have not filed Form 990 series returns or notices annually as required for three consecutive years.

[39] See, for example, "Inside the Hidden World of the Thefts, Scams and Phantom Purchases at the Nations Nonprofits" *The Washington Post* (October 26, 2013), available at http://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71_story.html

- Have filed a Form 990-N (e-Postcard**)** annual electronic notice.

The IRS also makes information about exempt organizations available through the Exempt Organizations Business Master File Extract, which contains more detailed information about organizations, such as their 501(c) sub-section, filing requirement, and financial data based on their Form 990 filing information.

It is also possible to view a tax-exempt organization's Form 990 on GuideStar and a public charity's Form 990 may be available on the web sites of various state charity regulators. Some exempt organizations, typically for transparency reasons, choose to post their Forms 990 on their own web sites. As a result, individuals with access to the internet can view an exempt organization's Form 990 and draw their own conclusions from the information they find there.

d. Form 990 filing organizations also may use Form 990 data to compare their organization's structure, management, compensation or performance with that of other organizations.[40] Additionally, they may use the Form 990 as a communication tool to provide information about their activities to donors, potential donors and the public. Many exempt organizations post their Form 990 on their website.

F. Information on Open Data

The IRS makes the Forms 990 filed by exempt organizations available only as single, individual image files specific to each exempt organization. The Form 990 data is not currently publicly available in a comprehensive, aggregated manner. It can be used and analyzed only on the basis of one exempt organization at a time. Many have lauded the virtues of open data for the nonprofit sector. Interested groups with which we met praised the advantages of open data, include improving the nonprofit sector as a whole by the ability of exempt organizations to compare themselves to other similarly situated entities, allowing states to better detect fraud and similar conduct, helping the nonprofit sector research sector-wide issues, and assisting the public and governments in tracking government and private grants and spending.

The Aspen Institute has devoted significant resources to studying the Form 990 and its data, the results of which it published in "Information for Impact: Liberating Nonprofit Sector Data." The Aspen Institute report promotes many benefits of open Form 990 data, including increasing the transparency for nonprofit organizations, making it easier for state and federal authorities to detect fraud, spurring innovation in the nonprofit sector and making the data useful for researchers, advocates, entrepreneurs, and

[40] Information excerpted from "Information for Impact," op.cit., pp. 28, 47-50.

technologists, as well as nonprofit organizations that do not have the resources to use the data in its current form.[41] To illustrate the public benefit to having open data, the report notes that when the U.S. Department of Health and Human Services published its database of hospital infection rates online in a searchable format, Microsoft and Google were able to create an application showing infection rates for local hospitals across the country, which gave the public information on which hospitals were the safest regarding infections.[42]

Congress has deemed that there should be no perceived penalty for e-filing, thus the IRS Exempt Organizations Division is limited in its use of the data submitted by electronic filers. Only those data fields that are transcribed from the paper-filed returns are extracted from the electronic data files and used for data-mining. However, EO Examinations personnel looks at the entire return (whether paper-filed or e-filed) when case building.

The guidelines for which data fields are transcribed are found in the Internal Revenue Manual (IRM) Section 3.24.12. The introduction to this section (effective January 1, 2015) of the IRM states:

1. This section provides instructions for the transcription and verification of data from block control documents and returns for the Business Master File Processing of the Exempt Organization Returns, using the Integrated Submission and Remittance Processing (ISRP) system.

2. Transcription operators may also need to refer to IRM 3.24.38, BMF General Instructions, for general procedures. If IRM 3.24.12 and IRM 3.24.38 conflict, IRM 3.24.12 takes precedence.

3. Beginning January 2009, transcribers [began to] see a new revision of Form 990 (2008). Forms 990 for a 2007 and prior year revision, and Forms 990 for 2008 and subsequent year revision, should be batched and processed under two separate program codes. See IRM 3.24.12.2.3.

Another system by which the IRS utilizes Form 990-series return data is the production and presentation of Statistics of Income (SOI) data. SOI conducts annual studies on charitable and other tax-exempt organizations. Analysts derive estimates of tax-exempt sector financial activity from a sample of Forms 990 filed by these organizations.

[41] B. Noveck and D. Goroff, *Information for Impact: Liberating Nonprofit Sector Data*, op. cit., p.2.
[42] *Id*. at page 4.

Organizations covered by the SOI sample include those exempt under Internal Revenue Code Sections 501(c) (3) through 501(c)(9). The IRS SOI "SOI Tax Stats - Charities & Other Tax-Exempt Organizations Statistics" webpage contains information under the headings Statistical Tables, Publications and Papers, and Microdata Files.

Forms 990 are ranked by SOI by asset size in the following strata for presentation:

- Less than $100,000
- $100,000 - $500,000
- $500,000 - $1 million
- $1 million – $10 million
- $10 million – $50 million
- Greater than $50 million

Selections are random with more returns chosen in the higher assets strata. Every year, all returns with greater than $50 million in assets are included in the SOI sampling. SOI staff transcribes some of their own data and may "correct" some data for sampling purposes, thereby creating their own unique SOI dataset. The dataset, in ASCII flat file format, that is used by SOI is not the same as the data used by EO Examinations for compliance.

The Data Management Division (Like SOI, a part of IRS SAS) team uses a process it calls "shredding" the data to create the datasets. In this process, XML (extensible markup language) data streams come into a relational database, then developers use that data to populate Oracle tables. Then, SOI editors review forms pre-filled with data and ask "does that look right?" At this point, team members may alter the data to reach a more logical answer if it does not appear correct. SOI uses both paper transcription data and e-filed data to produce its statistics. From this process, SOI creates Microdata files and tables and subtables that are published on the IRS SOI website.

The IRS contracts with an outside vendor[43] to process Forms 990-N (e-Postcard). As mentioned previously, the data provided annually by Form 990-N filers does not include financial information other than an affidavit that states that revenues for the filing year were normally not more than $50,000.

The IRS is significantly burdened by its outdated technology infrastructure, which results in the duplication of efforts, contracts with outside vendors, and the underutilization of data. In our discussions with individual IRS exempt organizations

[43] Currently, the IRS has an arrangement with the Urban Institute for this processing.

managers, we identified the following advantages of all-electronic filing of the Form 990 and Form 990-EZ:

1. Higher utilization of Form 990 data for tax compliances and other reasons. Currently, the IRS Exempt Organizations division only utilizes from the electronically filed returns the same information that is manually transcribed from the paper returns for its data analytics functions, for parity reasons. EO specialists have developed data-mining queries based on information within the Form 990 to identify potential areas of noncompliance. The IRS has developed a listing of over 150 condition codes based on responses to various Form 990 questions to identify potential noncompliance issues.[44] Currently, however, only about 40 percent of the core form and very little information from the schedules is manually entered. With all-electronic filing, the IRS could search and utilize all the information reported on the Form 990, not just what is manually entered from the paper forms.

2. More complete returns. If every return is electronically filed, then the IRS could eliminate the incomplete return program because electronically filed returns must be complete before being accepted for electronic filing.

3. Financial savings. The Aspen Institute reports that if the IRS makes e-filed data available in open form, it would save $350,000 in the cost of data conversion and $250,000 from a reduced need to conduct quality assurance checks.[45] Note, the IRS previously purchased from GuideStar expanded transcribed Form 990 data that GuideStar makes available to a number of customers and stakeholders. The IRS discontinued this arrangement with GuideStar in 2015 as EO shifted its focus to increasing its internal transcription of the Form 990.

4. Reduces human error from manual input and review. Electronic filing reduces human error from manual input and manual review of information returns to determine if returns are complete and accurate.

5. Open data for the sector; comparability. Electronic filing would allow exempt organizations to better compare themselves to similarly situated organizations if the data becomes searchable

[44] *Tax-Exempt Organizations, Better Compliance Indicators and Data, and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations*, Report to the Ranking Member, Committee on Homeland Security and Governmental Affairs, U.S. Senate by the United States Government Accountability Office ("GAO Report") (December 2014).
[45] B. Noveck and D. Goroff, *Information for Impact: Liberating Nonprofit Sector Data*, op cit., p. 18.

G. Government Accounting Office Report on Tax-Exempt Organizations

On December 17, 2014, the IRS received a progress report on charity oversight from the Government Accounting Office (GAO). The GAO Report took the form of a report addressed to Senator Tom Coburn in his role as the Ranking Member of the Senate Committee on Homeland Security and Government Affairs and is entitled, "Better Compliance Indicators and Data, and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations." The report is 60 pages long and the information is based on the GAO's performance audit conducted from June to December 2014. The performance audit involved a review of IRS documents and data and interviews with personnel involved in the agency's oversight activities.

Ultimately, the GAO's recommendations to the IRS were as follows:

1. Direct EO to develop quantitative, results-oriented compliance goals and additional performance measures and indicators that can be used to assess the impact of exams and other enforcement activities on compliance.

2. Continue to work with Treasury officials to review the flexibility afforded under [the Pension Protection Act] consistent with statutory protections of taxpayer data, clarify what flexibility state regulators have in how they protect and use federal tax data, make modifications to guidance, policies, or regulations as warranted, and clearly communicate this information with state charity regulators.[46]

GAO also recommends that Congress consider expanding the mandate for Section 501(c)(3) organizations to electronically file their information returns to cover a greater share of filed returns.[47] The GAO Report notes that the e-filing rate for tax-exempt organizations is significantly lower for exempt organization information returns than for partnership and S corporation returns and that an e-filing mandate would be useful to state regulators, charity watch-dog groups, charitable beneficiaries, and the press as a strategy for improving transparency and accountability. In written comments, the IRS agreed with GAO's recommendations.[48]

The report gave us insight into how the IRS Exempt Organizations Division selects organizations for examinations, stating that the IRS relies on seven primary categories of sources for determining which organizations to examine:

[46] GAO Report, p. 42
[47] GAO Report, p. 41.
[48] GAO Report, p. 42.

1. Analytics – based on Form 990 queries
2. Projects – staff-initiated projects approved by an executive committee to address compliance concerns
3. Compliance checks – letters and questionnaires sent to organizations based on data analytics, samples, or items in returns
4. Review of operations – IRS review of internal information, websites, and public documents to ensure that organizations are acting consistently with their tax-exempt purposes
5. Document matching – review of payor/employer records that do not match information returns
6. Referrals – referrals alleging potential noncompliance with the tax law from the general public, members of Congress, federal and state governments, and other divisions within the IRS
7. Claims – certain refund claims or request for abatement that require review

The GAO reported that the 4,495 IRS EO examinations conducted in 2013 were selected according to the following categories, by percentage:

- IRS National Research Program project on employment taxes and other – 41.2%[49]
- Form 990 data analytics – 22.1%
- Document matching – 9.9%
- Referral received from outside IRS – 8.0%
- Referral received from inside IRS – 5.7%
- Review of Operations – 4.0%
- Refund claims or requests for abatement – 3.2%
- Compliance checks (letters) – 2.9%
- Compliance checks (questionnaires) – 2.7%
- News items[50] – 0.4%

Overall, the examination rate for charities was 0.7% for 2013, compared to 1% for individual tax returns and 1.4% for corporate tax returns. Beginning in 2015, EO intends

[49] EO participated in an IRS National Research Program project on employment taxes in 2013, which contributed to an unusually high number of exams during that year. GAO Report, p. 18.
[50] "News items" include referrals the IRS received in the form of submitted news clippings; it does not include referrals received from members of the media, which IRS groups with referrals received from the general public. Also, the accountants among our readers will note that the percentages add up to 100.1% (even though the GAO's Table 2 presents the Total as 100%).

to rely more on data-mining queries from the redesigned Form 990 "to detect high-risk areas of noncompliance and to prioritize enforcement efforts."[51]

As previously stated, current law provides that only very large tax-exempt organizations are required to e-file a Form 990 (and we note that an organization that is eligible to file a Form 990-N may instead file, either electronically or on paper, a Form 990 or Form 990-EZ), making it more difficult for the IRS to use this data effectively in conducting examinations.[52] The GAO found that "referrals are prioritized so that those involving a serious breach of public trust or abuse—such as financial investigations or allegations of terrorism—are to be examined right away."[53] The report also states IRS EO managers explained, "On the other hand, high profile referrals—referrals resulting from a media exposé or involving a well-known organization—are not necessarily high priority, and may not be examined right away."[54]

The most common reason the IRS cites for revoking a charity's tax-exempt status is that the organization is not operating for tax-exempt purposes. The other primary reasons for revocation include failure to file tax returns, render statements, or maintain records and inurement/private benefit.[55]

As discussed elsewhere in this report, the GAO also noted that there is a lack of clarity in the area of what information may legally be shared between the IRS and state charity regulators to aid in their enforcement efforts.

The GAO Report notes that IRS budget and staffing levels have declined significantly over recent years and asserts that the EO division of the IRS will need to make sound decisions regarding the collection and use of performance data from exempt organizations or risk missing noncompliance, burdening tax-exempt organizations and wasting scarce resources.[56] The report also wisely notes that without sound data from exempt organizations, it will be difficult to communicate the EO's progress to Congress and the public.[57]

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[51] GAO Report, p. 27. See also, TE/GE Program Letter FY 2015, which states that the IRS's strategies include "[a]llocating resources using a data-driven approach to target existing and emerging high-risk areas."
[52] About 48% of exempt organizations e-filed in 2014. See footnote 24 and accompanying text, supra.
[53] GAO Report p. 18.
[54] *Id.*
[55] GAO Report, Figure 6: Number of Charitable Organization Returns with Revocations and the Reasons, Fiscal Years 2011-2013, p. 23
[56] GAO Report, p. 41.
[57] *Id.*

H. President Obama's Recommendation for Electronic Filing

In President Obama's Fiscal Year 2016 Revenue Proposals, the administration proposes a change to require all tax-exempt organizations to file the Form 990 series returns, including the Form 990-T, electronically. The proposal would also require the IRS to make the electronically filed forms publicly available in a machine-readable format in a timely manner. The proposal lists a number of advantages to mandatory e-filing of the Form 990, including use of the publicly available data by donors to make more informed contribution decisions, use by researchers, analysts and entrepreneurs to better understand the exempt organizations sector, and the creation of information tools and services to meet the needs of the sector, and also notes the usefulness of the data by state and local regulators, charity watch-dog groups, charitable beneficiaries and the press. According to the President's proposal, requiring electronic filing is unlikely to impose a large burden on tax-exempt organizations, since they generally maintain financial records in electronic form and either hire a tax professional or self-prepare returns using tax preparation software that enables electronic filing. The proposal states that in many cases, electronic filing is more cost effective for taxpayers.

I. Public.Resource.Org Case

On January 29, 2015, the United State District Court granted summary judgment to Public.Resource.org and ordered the IRS to produce nine requested Forms 990 in Modernized E-file (MeF) format to the charity within 60 days of the court's decision.[58] The court case arose because Public.Resource.org submitted a Freedom of Information Act (FOIA) request to the IRS seeking release, in MeF format, the Forms 990 filed electronically by nine tax-exempt organizations. The IRS refused to produce the requested documents, explaining that it did not have an existing process to convert the releasable portions of the Forms 990 back into MeF form due to the redaction required for publicly disclosure of the forms. The IRS asserted that it would have to shift resources, at a cost of $6,200, to develop the necessary protocol, train its employees, and develop the technical capacity to produce the requested Forms 990 in redacted MeF form.

In its decision, the court determined that the IRS could refuse to produce the documents, which are already in electronic format, only if there was compelling evidence as to a significant interference or burden to producing them in the redacted format. The court found that the IRS had "failed to make a compelling showing that accommodating the request to produce nine Form 990s in MeF at a cost of $6200 –

[58] *Public.Resource.org v. United States Internal Revenue Service*, Not Reported in F.Supp.3d, 2015 WL 393736 13-CV-02789-WHO (N.D.Ca. January 29, 2015).

much of which is characterized by the government as 'one-time expenses' to set up a protocol and train staff – would significantly burden or interfere with the agency's ability to respond to FOIA requests or meet its other responsibilities." The court also noted that if the IRS were to comply with additional requests to produce Forms 990 in MeF, the costs would be lower than to produce these initial nine copies.

J. Sharing Data with the States

In 2006, the PPA was enacted with provisions to facilitate information-sharing between IRS and state charity regulators. Prior to the enactment of the PPA, the IRS could share only certain information regarding the denial or revocation of recognition of an organization's tax-exempt status and notices of deficiencies. The PPA expanded the type of information state charity regulators can receive to include sensitive, confidential information, such as revenue agents' reports regarding proposed revocations and denials and notices of deficiencies. In addition, the IRS can now share information with the states on denials before an administrative appeal is made and before a final revocation or denial is issued.[59] In addition to the information IRS is now allowed to share with state charity regulators, IRS also makes revocations publicly available. The IRS lists revocations in the Internal Revenue Bulletin, although the reason for revocations resulting from exam are not given or made public.[60] Redacted revocation reports are posted to the electronic reading room; these reports generally provide the reason for the revocation.

Specifically, Code Section 6104(c) on publication to state officials states the following:

> **(1) General rule for charitable organizations**
> In case of any organization which is described in section 501(c)(3) and exempt from taxation under section 501(a), or has applied under section 508(a) for recognition as an organization described in section 501(c)(3), the Secretary at such times and in such manner as he may by regulations prescribe shall—
>
> **(A)** notify the appropriate State officer of a refusal to recognize such organization as an organization described in section 501(c)(3), or of the operation of such organization in a manner which does not meet, or no longer meets, the requirements of its exemption,
>
> **(B)** notify the appropriate State officer of the mailing of a notice of deficiency of tax imposed under section 507 or chapter 41 or 42, and

[59] Code Section 6104(c)(2). See also, GAO Report, p. 37.
[60] *Id.*

(C) at the request of such appropriate State officer, make available for inspection and copying such returns, filed statements, records, reports, and other information, relating to a determination under subparagraph (A) or (B) as are relevant to any determination under State law.

(2) Disclosure of proposed actions related to charitable organizations

(A) Specific notifications
In the case of an organization to which paragraph (1) applies, the Secretary may disclose to the appropriate State officer—

(i) a notice of proposed refusal to recognize such organization as an organization described in section 501 (c)(3) or a notice of proposed revocation of such organization's recognition as an organization exempt from taxation,

(ii) the issuance of a letter of proposed deficiency of tax imposed under section 507 or chapter 41section 507 or chapter 41 or 42, and

(iii) the names, addresses, and taxpayer identification numbers of organizations which have applied for recognition as organizations described in section 501 (c)(3).

K. State Charitable Solicitation Filings

At the time of this report, 39 states and the District of Columbia require organizations seeking to solicit contributions in their jurisdiction to register.[61] The vast majority of these states and the District of Columbia accept the Unified Registration Statement (the "URS") in connection with these registrations. All but three states have adopted the URS for charitable solicitation filings. Much of the information requested on the URS is similarly requested by the Form 990 and its schedules. The URS, however, has two line items that require data not generally found on Form 990 currently. URS Line 7 asks:

Has organization or any of its officers, directors, employees or fund raisers (Yes/No):

A. Been enjoined or otherwise prohibited by a government agency/court from soliciting?
B. Had its registration denied or revoked?

[61] *Nonprofit Fundraising Registration: The 50-State Guide*, by Stephen Fishman and Ronald J. Barrett, NOLO Press (2013).

C. Been the subject of a proceeding regarding any solicitation or registration?
D. Entered into a voluntary agreement of compliance with any government agency or in a case before a court or administrative agency?
E. Applied for registration or exemption from registration (but not yet completed or obtained)
F. Registered with or obtained exemption from any state or agency?
G. Solicited funds in any state?

If "yes" to 7A, B, C, D, E, *attach explanation*.
If "yes" to 7F & G, *attach list* of states where registered, exempted, or where it solicited, including registering agency, dates of registration, registration numbers, any other names under which the organization was/is registered, and the dates and type (mail, telephone, door to door, special events, etc.) of the solicitation conducted.

Then, on Line 15 of the URS, the form requires filers to attach separate sheet listing names and addresses (street & P.O.) for all below:

- Individual(s) responsible for custody of funds.
- Individual(s) responsible for distribution of funds.
- Individual(s) responsible for fund raising.
- Individual(s) responsible for custody of financial records (Form 990, Part VI, Line 20)
- Individual(s) authorized to sign checks.
- Bank(s) in which registrant's funds are deposited (include account number and bank phone number).

In addition, fourteen states require supplemental forms in addition to filing the URS. Examples of additional information are as follows:

Georgia: Ten-year employment history for all “control persons”, defined as anyone, “who directly or indirectly, has the power to direct or cause the direction of the management and policies of the applicant [charity].”

West Virginia: A three-question supplement asks about amounts raised in West Virginia, amounts disbursed for program services in West Virginia, and amounts disbursed for charitable purposes outside West Virginia.

Utah: Two supplemental statements that include a special Utah version of a "Utah Financial Report/Statement of Functional Expenses" (which has a 5-page set of instructions.)

Tennessee: Two supplemental statements including a "Summary of Financial Activities of a Charitable Organization" which includes a restatement of data that is already being reported on Form 990, Parts VIII and IX.

Washington: A three-page "Washington State Unified Registration Statement Addendum" that requires financial information in an 8-line "Solicitation Report" already being reported on Form 990, Parts VIII and IX, although the terms used ("The total gross dollar value of expenditures used for administrative and fundraising") are unique to the state.

In addition to initially registering to solicit contributions, soliciting organizations also must file renewal forms in the various states and the District of Columbia. The renewal forms differ from state to state and generally require detailed financial information, much of which is available on and taken directly from the Form 990. Organizations are typically required to file a copy of their Form 990 with their renewal forms.

IV. DUE DILIGENCE AND CONDUCTING THE SURVEY

A. Meetings and Research

The ACT reviewed the Form 990, along with schedules and instructions, and online resources provided on the Form 990 on the IRS website.

The ACT conducted a series of interviews and meetings with IRS officials and staff in June 2014, August 2014, October 2014 and January 2015. The interviews and meetings focused on the Form 990, Form 990 filers, methods of Form 990 filing, and how the Form 990 data is used once received. The groups also discussed how changes to the Form 990 and its instructions are received, approved by leadership, budgeted for revision, and ultimately revised for dissemination. We are grateful for the information shared by IRS officials and staff.

The ACT also met with Statistics of Income (SOI) staff to learn more about how the Form 990 data is used and disseminated by the agency and its partners.

The ACT consulted several reports, including *Information for Impact, Liberating Nonprofit Sector Data*, by Beth Simone Noveck and Daniel R. Goroff, Second Edition (2013), *The Aspen Institute Philanthropy and Social Innovation* (2013), and the

Government Accounting Office's *Report to the Ranking Member Committee on Homeland Security and Government Affairs, US Senate, Tax-Exempt Organizations: Better Compliance Indicators and Data and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations (*2014). In addition, the ACT conducted independent research on the topics addressed in this report.

The ACT also met with several different organizations, individuals and associations with nonprofit constituencies and interest in the Form 990 ("stakeholder groups") and its impact on nonprofit organizations and the nonprofit sector. Meetings were set up to ascertain and learn about these stakeholder groups' thoughts on the how the Form 990 is working and what changes in the Form, its instructions, filing and data sharing they would like to recommend. The meetings took place either in person or via telephone conference call.

The acknowledgement section of this report includes a list of the stakeholder groups outside of federal government representatives with whom we have consulted. While many of the themes of the comments were repeated among the various stakeholder groups, not every organization expressed views on each topic.

B. Survey on the Form 990

Additionally, the ACT conducted a survey to collect input and recommendations on the Form 990 from a wide group of Form 990 stakeholders, including representatives of exempt organizations that file a Form 990, Form 990-EZ or Form 990-N, state and local government officials (charity officials and others), donors, advisors to donors, advisors to grant makers, practitioners (including attorneys and accountants), researchers, independent charity rating agencies, and members of the press. The ACT reached out to various industry groups, as set forth on **Appendix A**, which distributed the survey to their members. These groups were selected based on their members' extensive involvement with and use of the Form 990.

For purposes of conducting the survey, the ACT developed an online survey tool. Links to the survey tool were sent to prospective respondents via email starting on January 13, 2015. The survey remained open until February 10, 2015. Primary dissemination of survey invitations was sent through membership lists, affinity groups and associations of the stakeholder groups. A list of the groups invited to participate is found in **Appendix A**. These groups were invited to participate once or more than once between January 13, 2015 and February 6, 2015. The survey was also disseminated by ACT members to their professional contact lists, former members of the Exempt Organizations Subcommittee of the ACT, state and local government representatives, and other interested individuals. In addition to email invitations, others received an invitation to

participate during conference plenaries and sessions. For a list of these verbal invitations to participate, see **Appendix A**.

In completing the questionnaire, individuals were asked to first self-identify the manner in which they primarily use or review Forms 990. Individuals who identified themselves as part of the staff, board, or development team of an exempt organization then were asked to respond to questions regarding their organization's completion and filing of the Form 990. In this report, these individuals are referred to as "filers." Other individuals who self-identified themselves as state charity officials, donors, grant-makers, advisors, practitioners, or researchers or in similar capacities were then asked to respond to questions about their use of Forms 990 filed by exempt organizations. For purpose of this report, these individuals are referred to as "reviewers" of the Form 990. In many instances, an individual may be a member of both of these groups, but for the purposes of this survey, respondents were required to self-identify their primary use of the Form 990.

While technology was in place to preclude respondents from entering more than one response from the same computer, there was no restriction on the number of times respondents could respond from a single organization. Survey respondents were assured that their individual responses would be confidential and that responses would be reported in the aggregate only and not attributed to individual respondents. We estimate that, on average, the survey took approximately 5 to 10 minutes to complete. There was no telephone follow-up or other specific contact with to survey respondents.

Many of the questions posed as part of the survey were dependent upon the type of respondent or questions previously answered by the respondent. While IRS staff provided input regarding survey questions prior to the survey's release, the survey was not conducted using IRS survey tools, resources or contact lists of exempt organizations from the Exempt Organization's Masterfile or other IRS email lists.

Due to the process of disseminating the survey by member/client lists of external associations and affinity groups (for which we have limited or no data on email open rates, duplicates, bad email addresses, etc.), it is not possible to report a response rate for the survey. The survey was neither based on a random sample nor statistically valid, but was intended to reach a broad group of Form 990 series filers and users. We estimate that at least 148,000 individuals were invited to participate in this survey through one of the channels indicated above. In all, 1,898 individual respondents participated in the survey. As this was not a random sample, however, survey results cannot be reliably extrapolated to the general population of all exempt organization filers and users of the Form 990.

C. Survey Results

The survey was intended to pose questions to various users of the Form 990, 990-EZ and/or 990-N to determine their perceptions of the forms, their views on their effectiveness, which parts and schedules of the Form 990 they have a difficult time completing (if applicable), which parts and schedules do they use the most in reviewing organizations, and where do they turn for help in completing the forms. With the exception of media users, the survey responders represent a broad cross-section of the various users of the Form 990, including representatives of filing organizations, researchers, donors and grantmakers, practitioners, and government officials. A full copy of the survey results in set forth in **Appendix B**.

a. General Results

When representatives of filing organizations that are not currently filing the Form 990 or 990-EZ electronically were asked if they would find mandatory electronic filing burdensome, only a small number answered "yes." Merely 1.92% of the Form 990 filers (9 out of 468) and 5.95% of the Form 990-EZ filers (5 out of 84) responded affirmatively that they would find mandatory electronic filing burdensome for their organizations. Of the Form 990 filers, 40.17% responded "don't now" and 10.72% of the Form 990-EZ filers responded with this answer. Note, the ACT recognizes that individuals responding to an on-line survey will likely have greater comfort with electronic filing. Below is a summary of the results from the question on electronic filing.

If you were required to file electronically a Form 990 or 990-EZ, would this negatively affect your organization?

	Yes	**No**	**Don't Know**
Form 990 filers	1.92%	57.91%	40.17%
Form 990-EZ filers	5.95%	83.33%	10.72%

Regarding which part or schedule of the Form 990 filers find the most difficult to prepare, the responders had no clear "favorite," with these three Parts/Schedules receiving the most support for difficulty:

- Part IX, Statement of Functional Expenses (11.61%).
- Part VII, Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors (5.74%)

- Schedule G, Fundraising and Gaming (5.33%).

Regarding which Form 990 part or schedule reviewers had the most difficult time understanding, again there was no clear frontrunner. Leading responses were

- Schedule K, Bonds (8.27%),
- Part IX, Statement of Functional Expenses (7.27%),
- Part XI, Reconciliation of Net Assets (7.02%).

Both filers and reviewers are in the middle ground on whether they believe the Form 990 encourages responsible board governance and executive behavior.

On a scale of 1 to 5, does the Form 990 (or EZ or N, as applicable) encourage responsible board governance and executive behavior? (5 being strongly encourages)

Average score of responses:

Form 990 filers	3.06
Form 990-EZ filers	3.37
Form 990-N filers	3.17
Reviewers	3.26

Similar outcomes resulted from the question to both Form 990 filers and reviewers on whether they believe the Form 990 is effective for communicating with the public about an organization's governance, programs and operations.

On a scale of 1 to 5, how effective is the Form 990 for communicating with the public about your organization's governance, programs and operations? (5 being the most effective) [62]

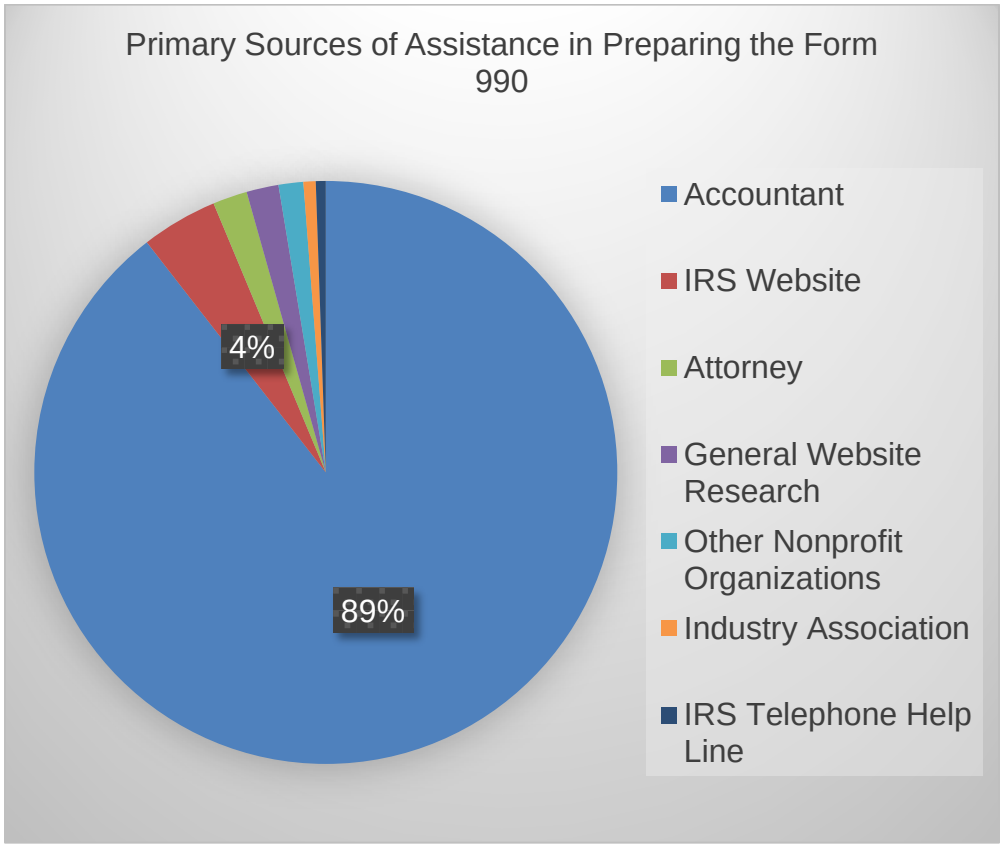
Average score of responses:

Form 990 filers	2.93
Reviewers	3.24

When Form 990 and Form 990-EZ filers were asked where they turn for help with completing their information returns, accountants were the overwhelming choice (Form 990 filers - 89.48% and Form 990-EZ filers - 67.88%). The IRS website took second

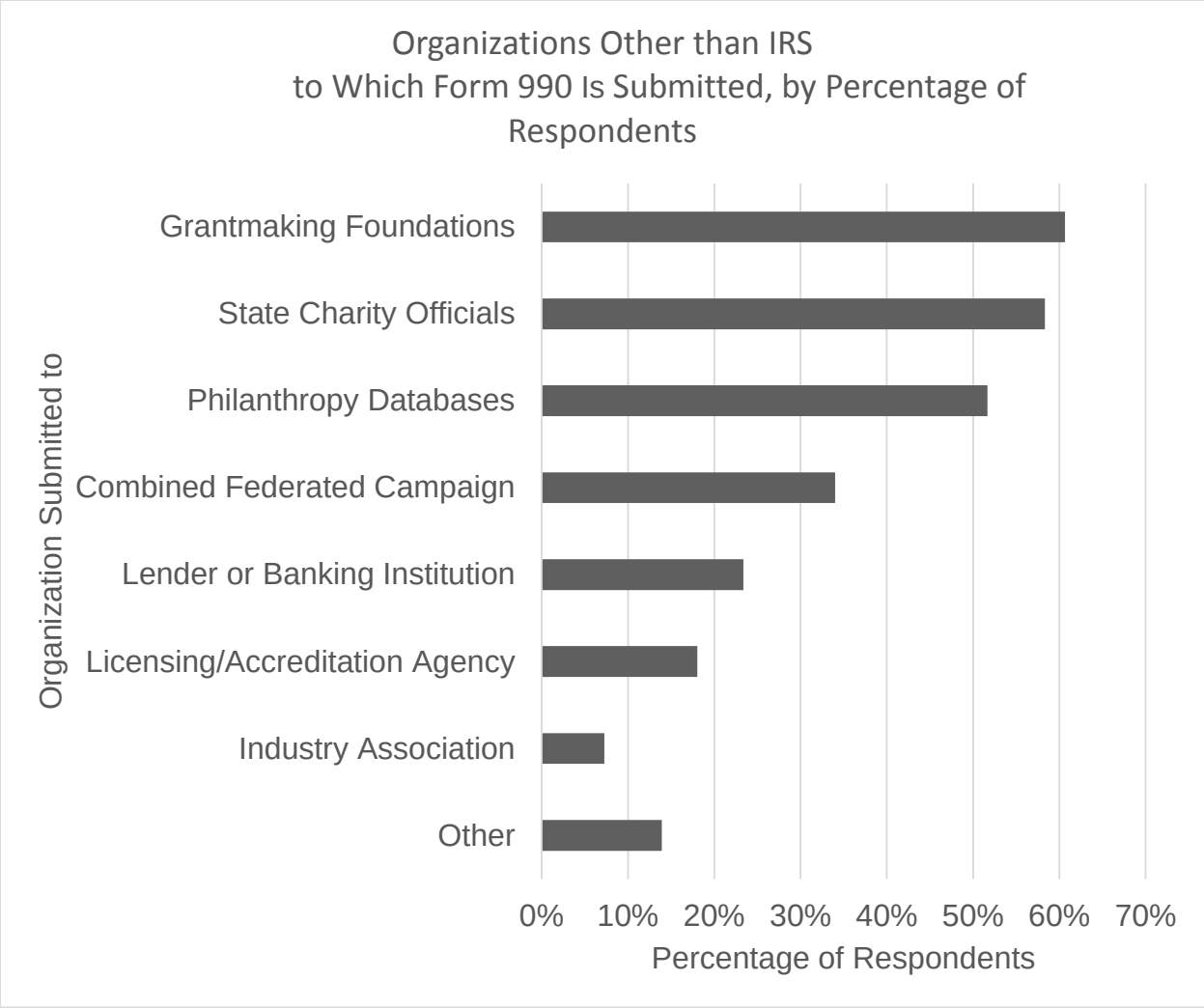
[62] Form 990-EZ and 990-N filers were not asked this question in the survey.

place with both the Form 990 filers (4.23%) and the Form 990-EZ filers (17.86%) for help with information return completion.



The survey confirmed that filing organizations submit the Form 990 with many other agencies and organizations. The three leaders in this category were

- state charity officials (58.33% of the Form 990 filers and 58.88% of the Form 990-EZ filers),
- grantmaking foundations (60.66% of the Form 990 filers and 54.76% of the Form EZ filers), and
- philanthropy database, such as GuideStar (51.64% of the Form 990 filers and 42.86% of the Form 990-EZ filers).



b. Form 990-N and Form 990-EZ Users

Somewhat imbedded in the Form 990 survey data were two interesting “sub-surveys” that consisted of users of Form 990-N (ePostcard) and Form 990-EZ. There were 37 Form 990-N filers and 92 Form 990-EZ filers. While the survey was widely distributed to Form 990 stakeholders, the filers responding to the survey were largely Form 990 filers rather than Form 990-N or Form 990-EZ filers.

The Form 990-N filers broke down as follows:

Development Directors	5
Staff, Board member, etc.	32

In this sub-survey, 36 of the 37 Form 990-N filers answered the five Form 990-N-specific queries, set forth below.

Would providing your total revenues and total expenses on Form 990-N be overly burdensome to your organization?

Yes	No
33.33%	66.67%

Does your organization have any paid staff?

Yes	No
44.44%	55.56%

When you need help completing Form 990-N where do you turn for that assistance?

Accountant	IRS Website	General Website Search	Attorney	IRS helpline	Other nonprofit
52.78%	19.44%	8.33%	5.56%	5.56%	5.56%

The survey asked in what state is the Form 990-N filer's organization headquartered and we saw a representative array of locations led by California with 14 and New York with 3.

On the question, "On a scale of 1 to 5, does the Form 990-N encourage responsible board governance and executive behavior? (5 being strongly encourages) the ratings were as follows:

5 13.89%
4 25.00%
3 38.89%
2 8.33%
1 13.89%

This data may be helpful with regard to strategizing how the IRS might review, examine and provide assistance to small organizations (see **Recommendation #3**). Although the Form 990-N filers participating in the survey represents a small, non-statistically valid sample, a majority of these organizations would not find it burdensome to provide information on revenue and expenses to the IRS (which could assist the IRS with post-Form 1023-EZ reviews) and appear more likely to utilize the IRS website for their questions.

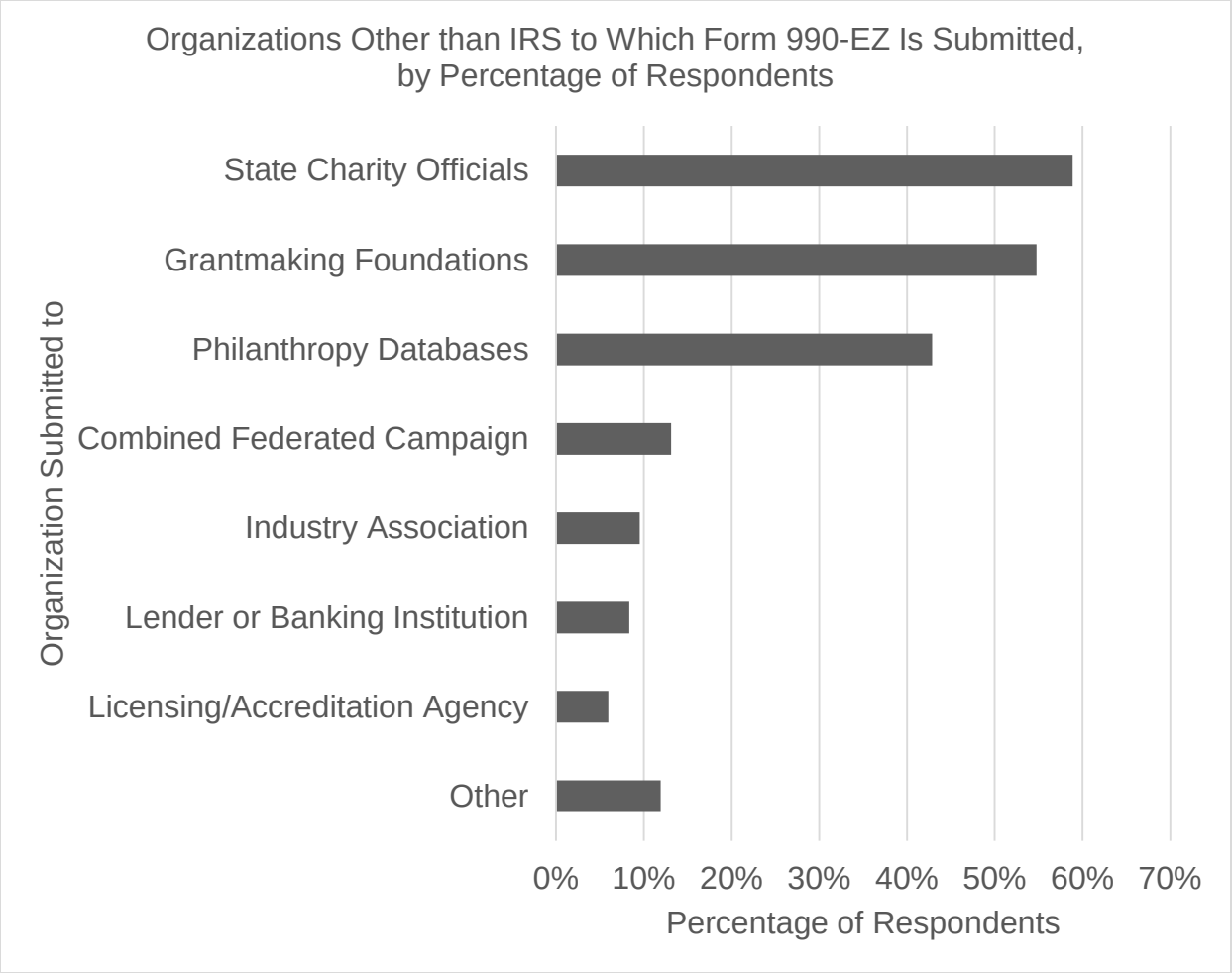
The Form 990-EZ filers broke down as follows:

Development Directors	15
Staff, Board member, etc.	77

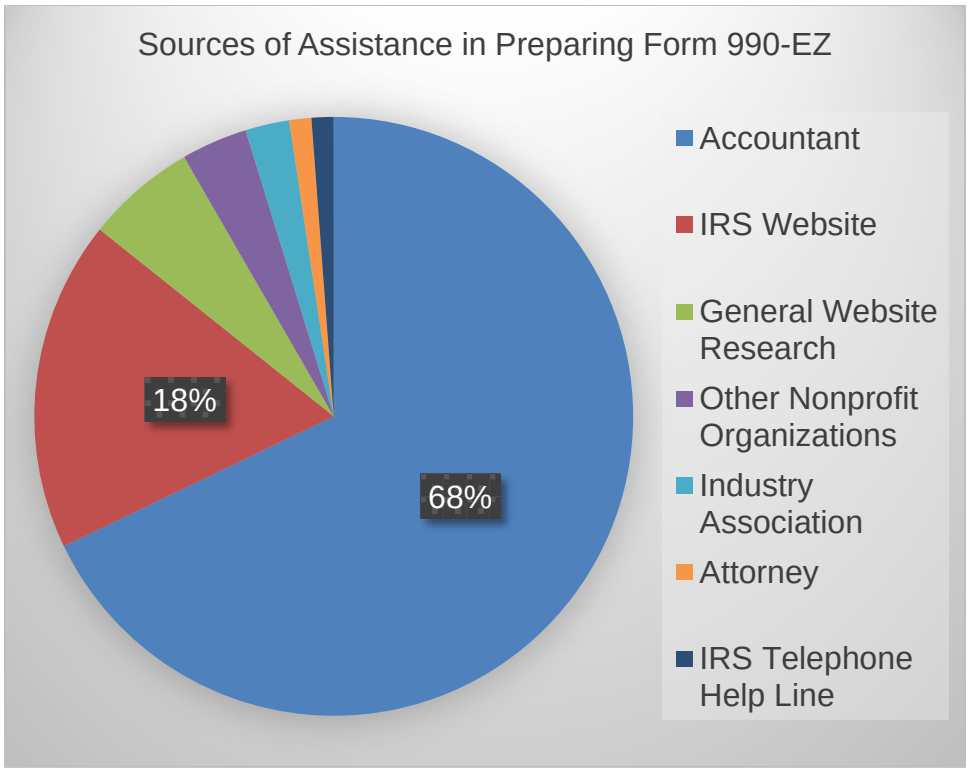
The survey asked what state the 990-EZ filer's organization was headquartered in and we saw a representative array of states led by California with 22 and Pennsylvania and Illinois tied for second with 7 each.

In this "sub-survey," 84 of the 92 Form 990-EZ filers answered the five 990-EZ-specific queries. For the question, "If you were required to electronically file a Form 990-EZ, would this negatively affect your organization?" 83.33% answered "No," 10.71% answered "Don't know," and only 5.95% answered "Yes."

On the question, "Other than filing the Form 990-EZ with the IRS, where else do you submit a copy of the Form 990-EZ? (Check all that apply)," the following was reported:



For “When you need help completing Form 990-EZ where do you turn for that assistance?” 67.89% answered “Accountant”, with 17.86% answering “IRS website”, and 5.95% stating “General website search.” Other nonprofit organizations received 3.57%. “Association (or other ‘industry organization’)” was the choice for 2.38%. Attorney and IRS telephone “help” line each came in with an identical 1.19%.



On the question, “On a scale of 1 to 5, does the Form 990-EZ encourage responsible board governance and executive behavior? (5 being strongly encourages) the ratings were as follows:

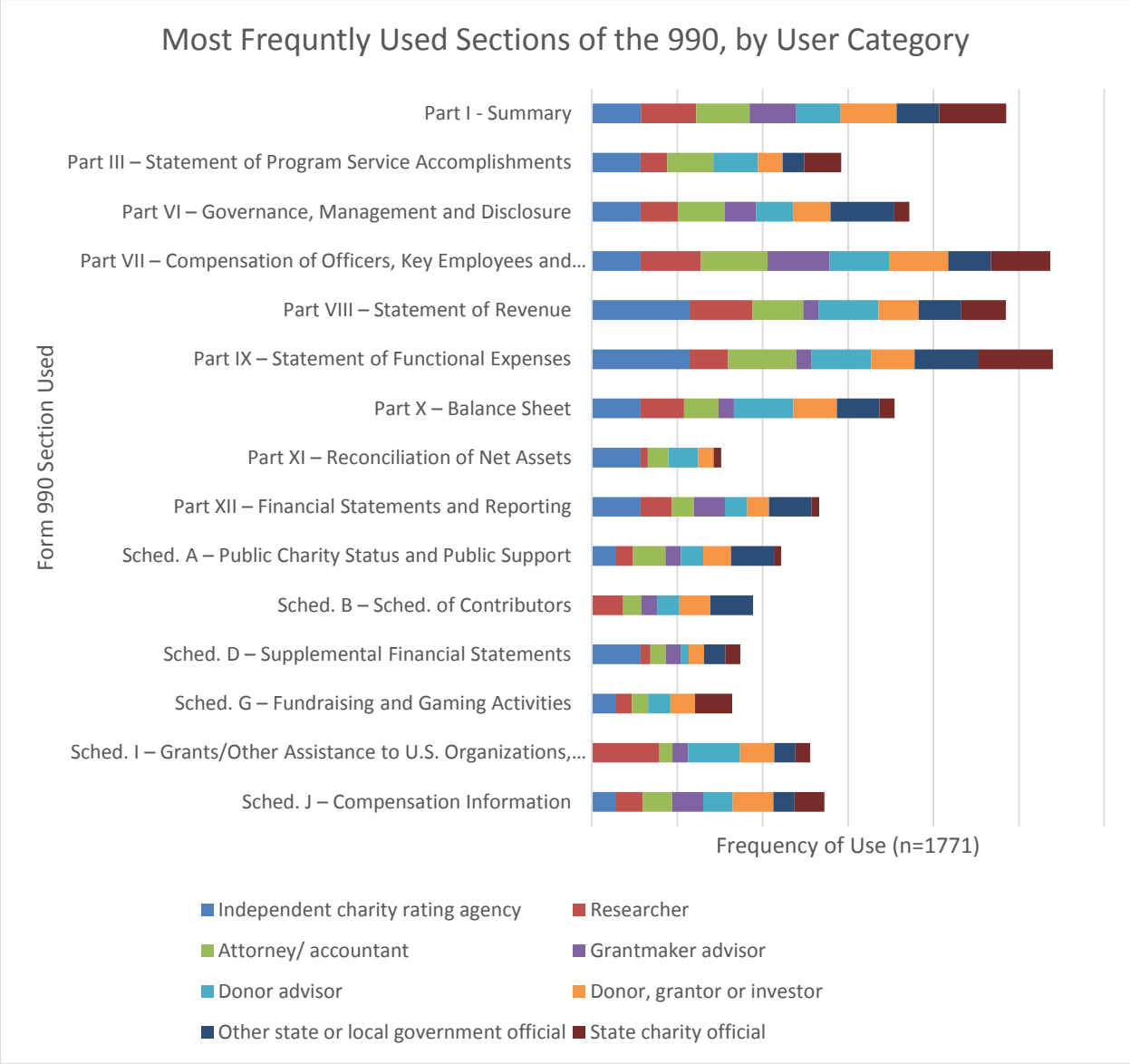
5	14.29%
4	29.76%
3	40.48%
2	9.52%
1	5.95%

Finally, Form 990-EZ users told us, when asked, “Does your organization have paid staff?”

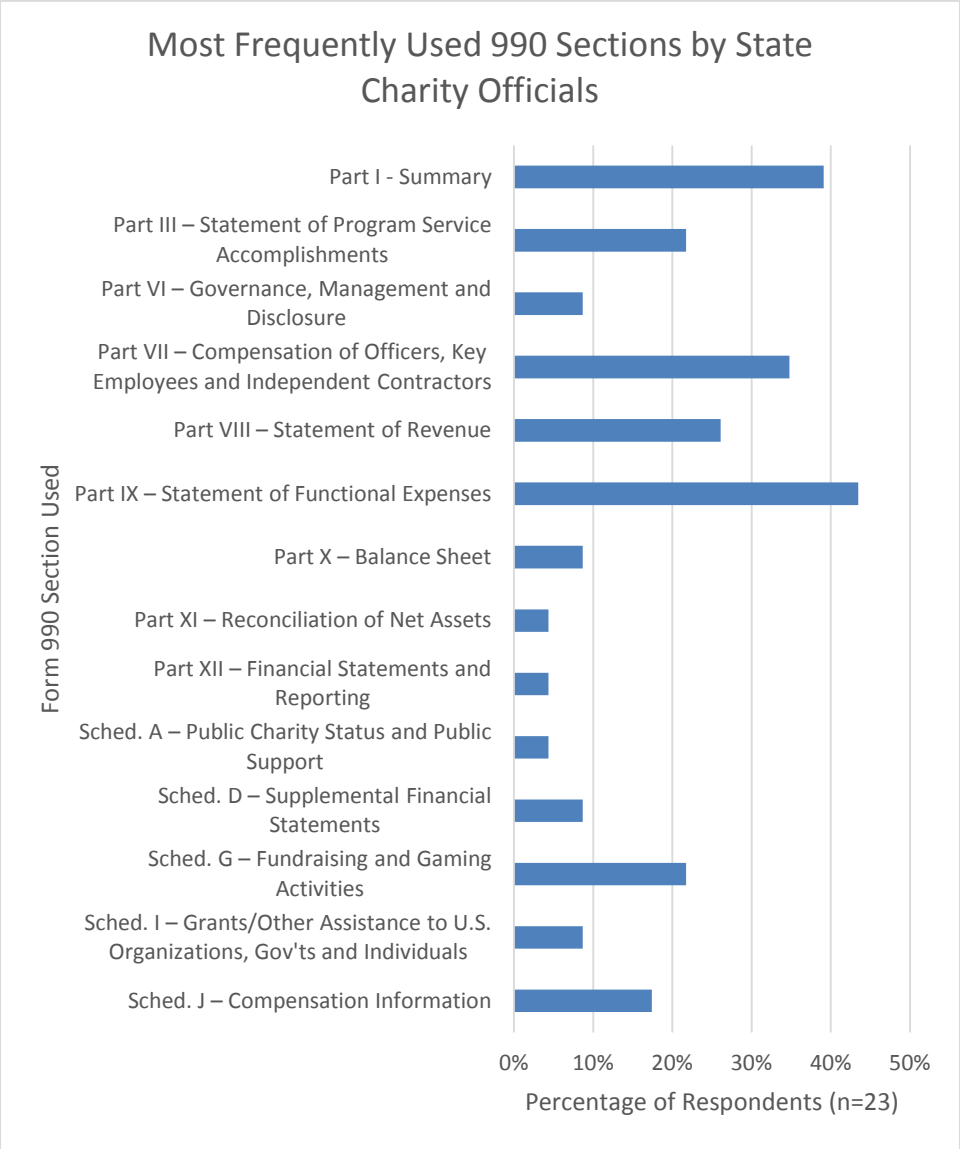
Yes	71.43%
No	28.57%

c. Uses of the Form 990

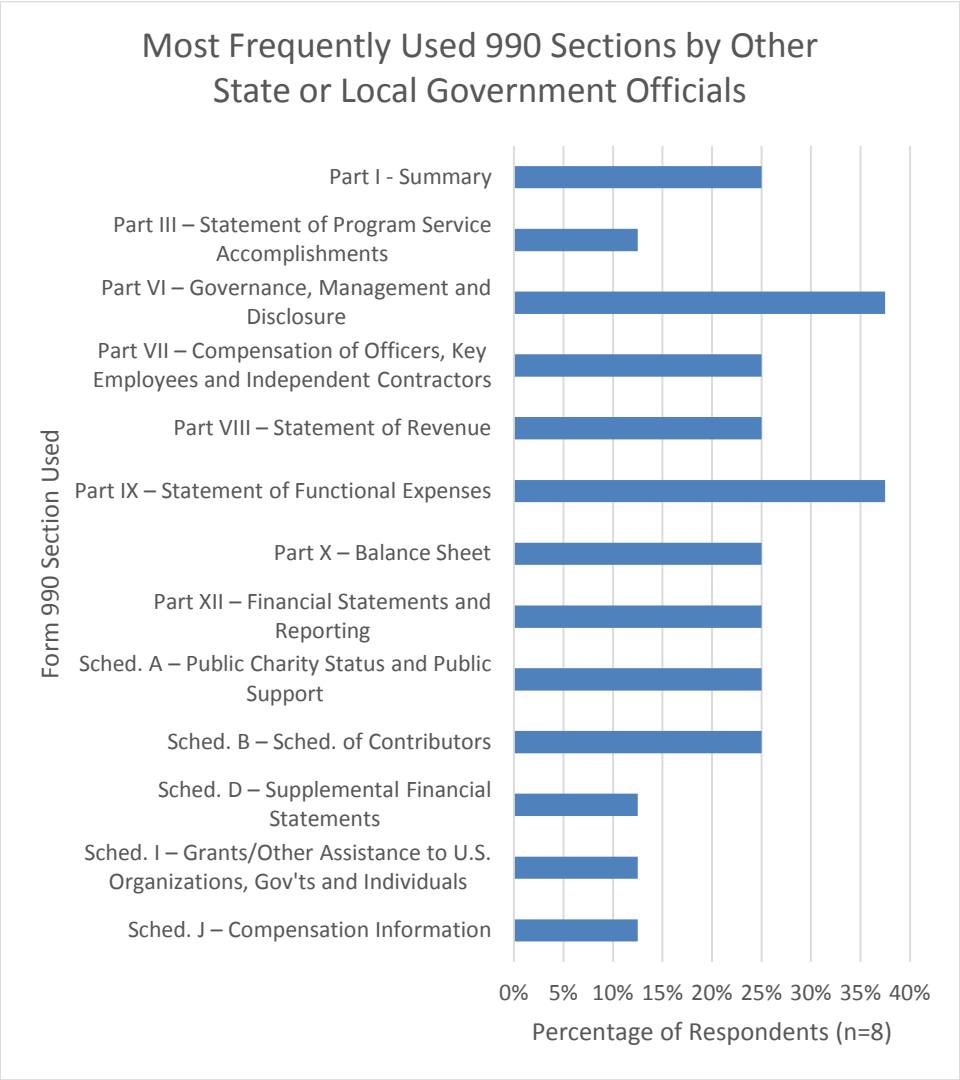
The ACT's survey also focused on the use of the Form 990 by the various users of the Form 990 data. A cross-tabs analysis was conducted for question 1 (users of Form 990) and question 29 (primary use of Form 990) to ascertain which parts and schedules of the Form 990 are used most frequently by each category of respondent, with each respondent being able to select up to three of the choices. The following chart shows the frequency of use by user type. The media category was not included because there was only one respondent in that category.



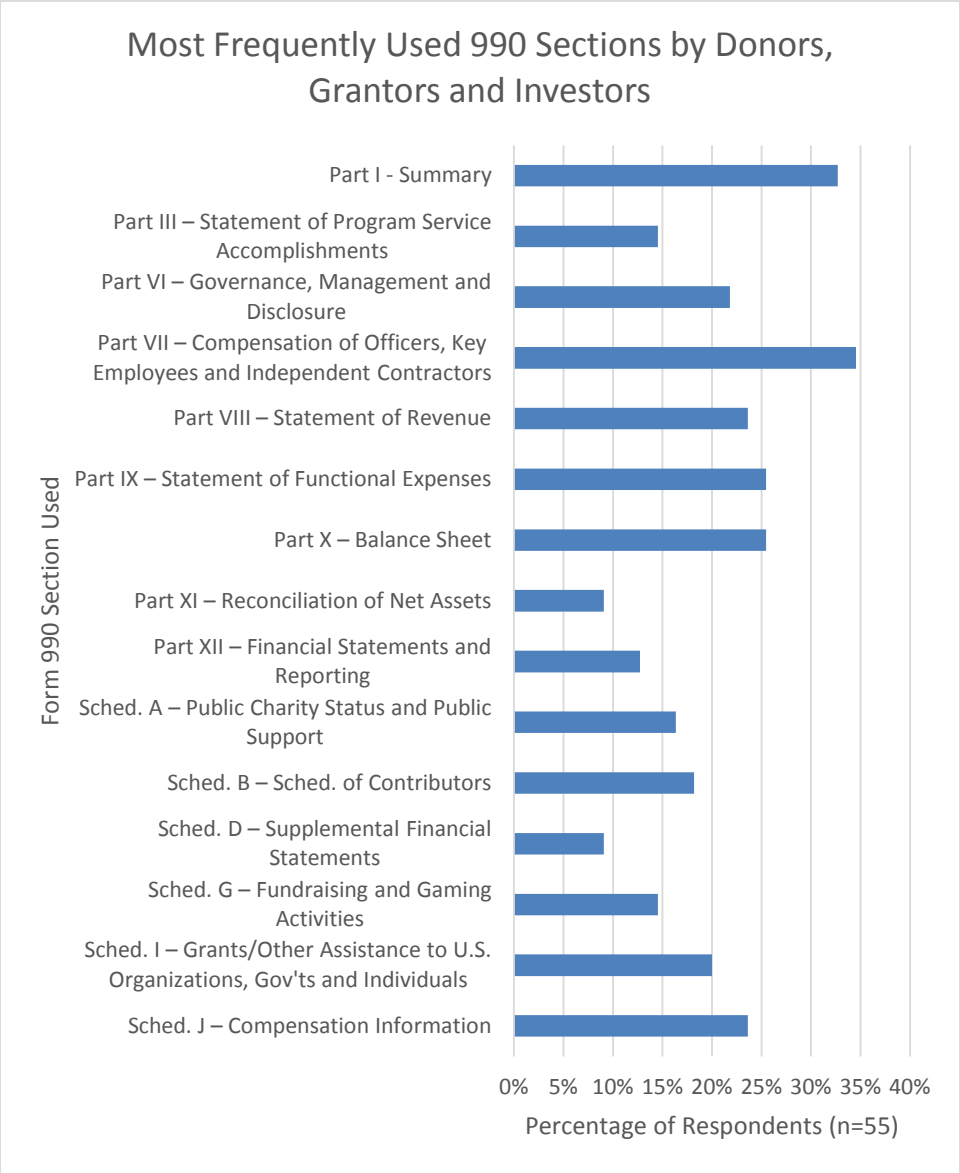
Among 23 state charity officials who responded to the survey, 43.5 percent said they use Part IX, Statement of Functional Expenses in their work. The next most frequently cited sections cited by state charity officials were Part I, Summary (39.1% of respondents) and Part VII, Compensation of Officers, Key Employees and Independent Contractors (34.8%). Other sections used were Part VIII, Statement of Revenue (26.1%), Part II, Statement of Program Service Accomplishments (21.7%), and Schedule G, Fundraising and Gaming Activities (21.7%).



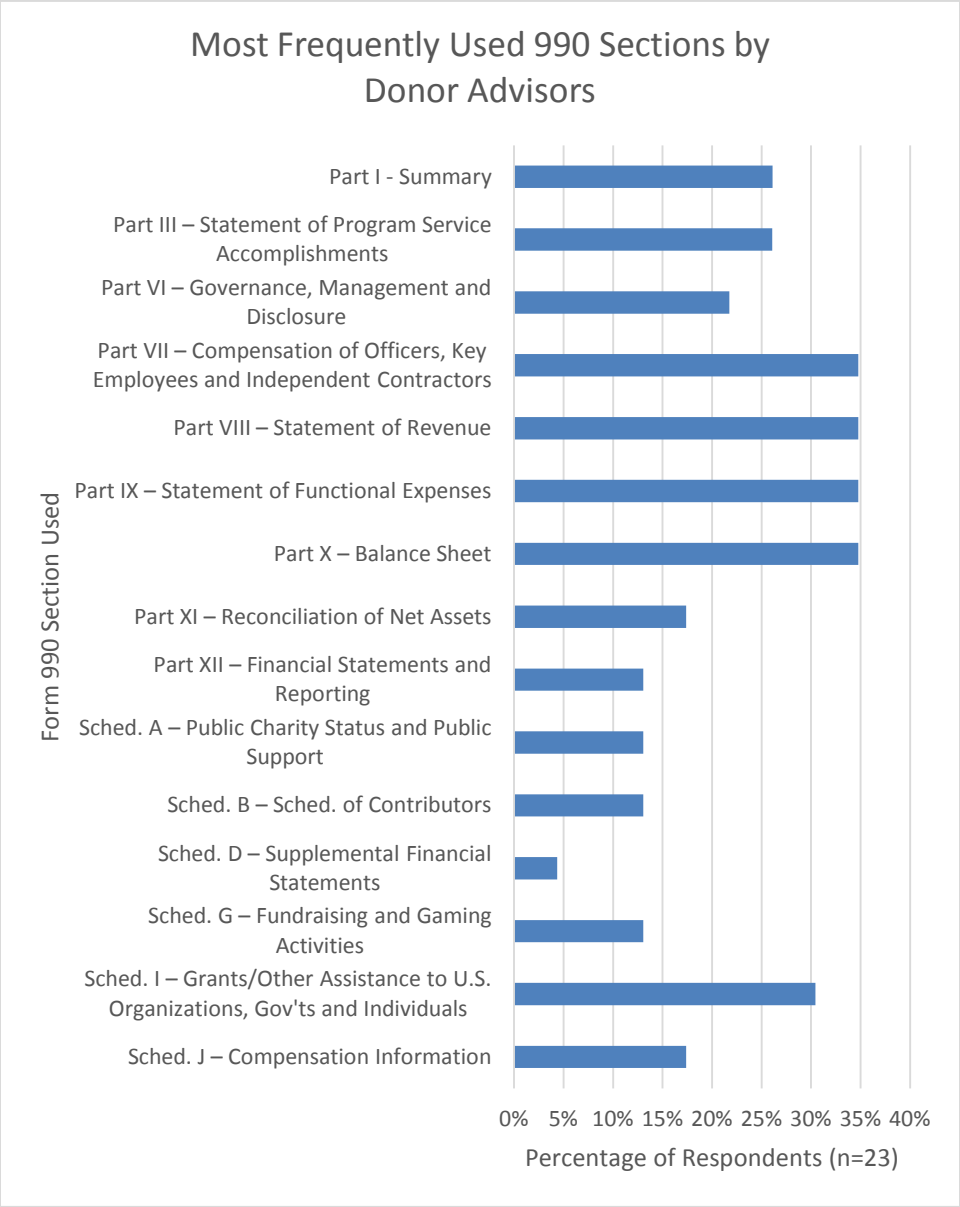
Eight other state or local government officials responded to the survey, citing Part VI, Governance, Management and Disclosure (37.5% respondents) and Part IX (37.5%) as the parts of the 990 data they primarily use in their work. Twenty-five percent of these officials said they use Part I, Part VII, Part VIII, Part X (Balance Sheet), Part XII (Financial Statements and Reporting), Schedule A (Public Charity Status and Public Support), and Schedule B (Schedule of Contributors).



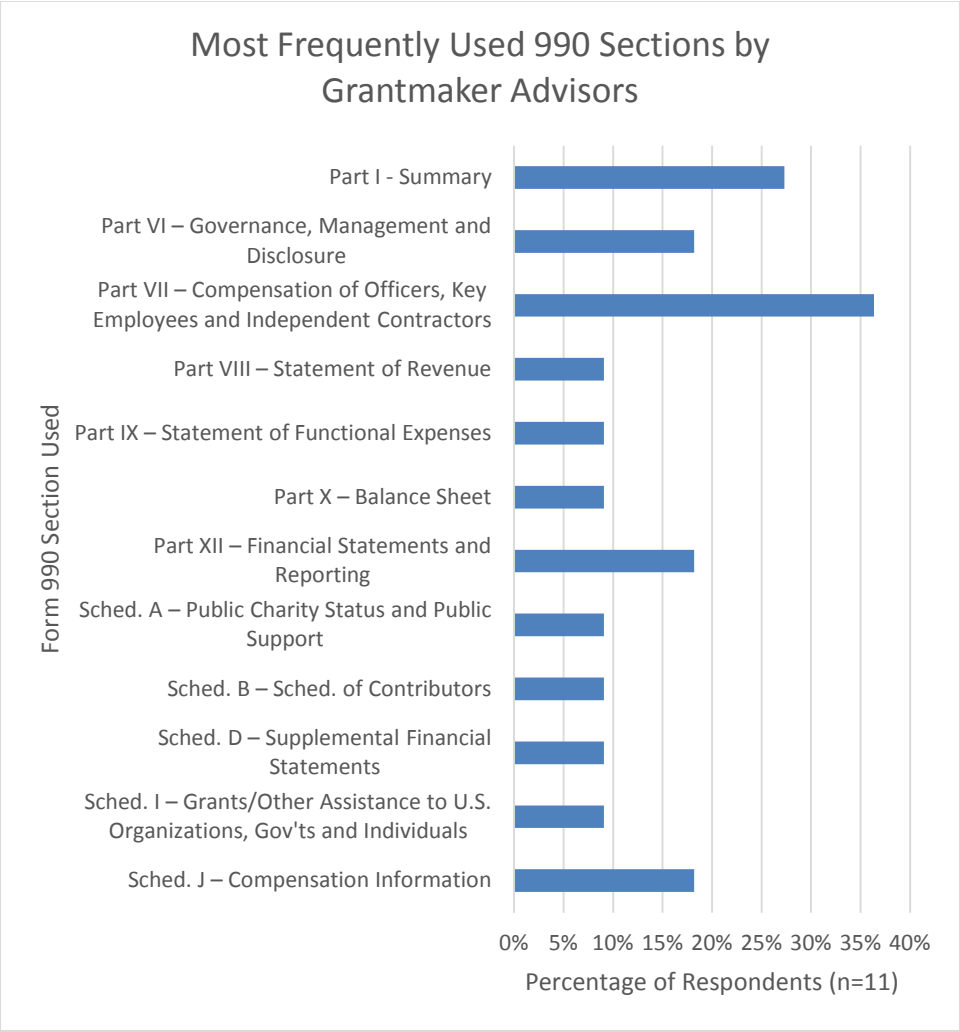
Donors, grantors and investors were most likely to say they use Part VII (34.5% of 55 respondents in this category) and Part I (32.7%) in their work. Twenty-five percent cited Parts IX and X. Part VII and Schedule J (Compensation Information) were cited by 23.6 percent of respondents in this category, Part VI was cited by 21.8 percent, and Schedule I (Grants/Other Assistance) was cited by 20 percent.



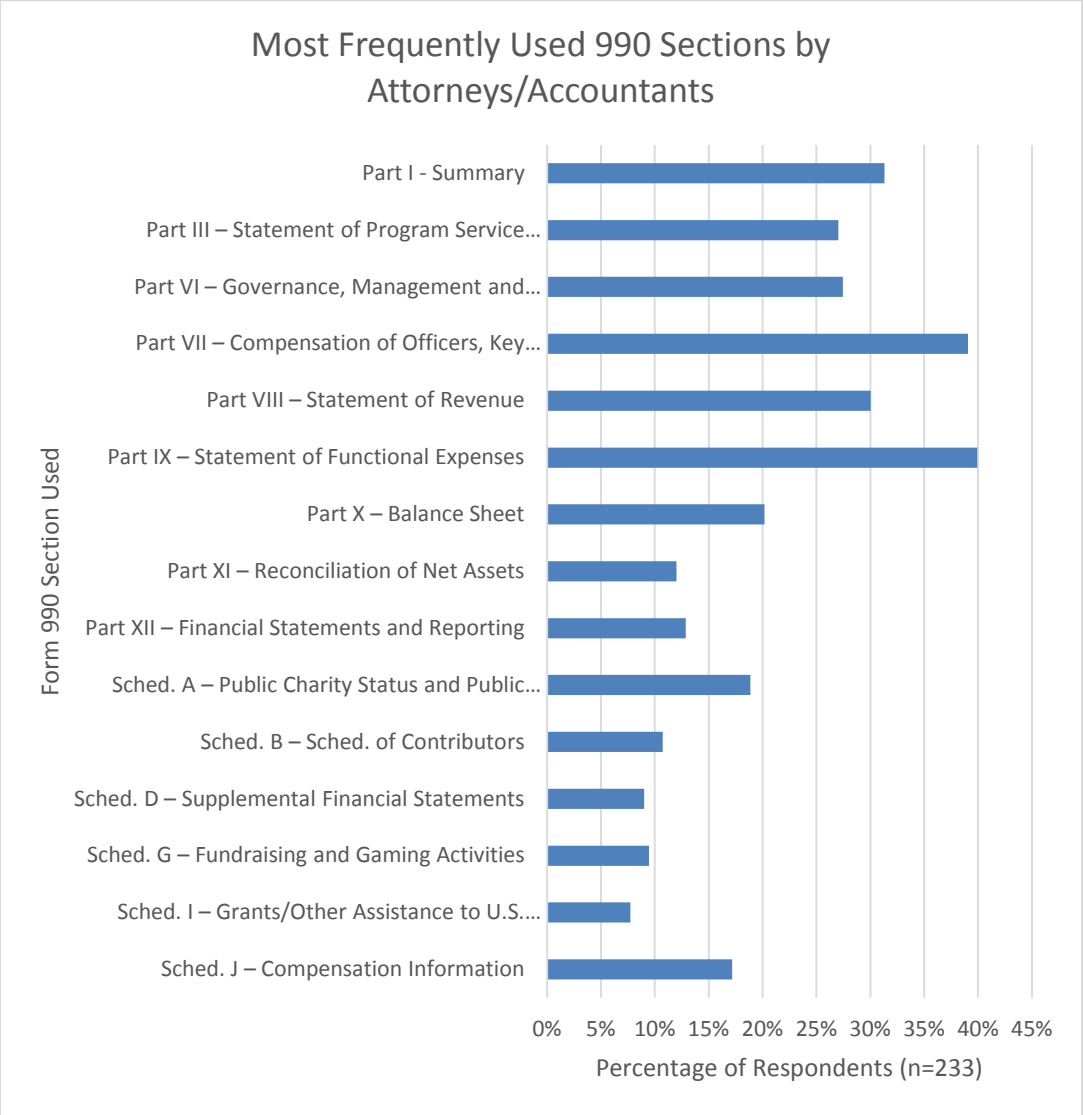
The four Form 990 data areas most frequently cited by the 23 donor advisors who responded were Parts VII, VIII, IX, and X (34.8% each). Schedule I is used by 30.4% of donor advisors, Parts I and III (Statement of Program Service Accomplishments) are used by 26.1 percent, and Part VI is used by 21.7 percent.



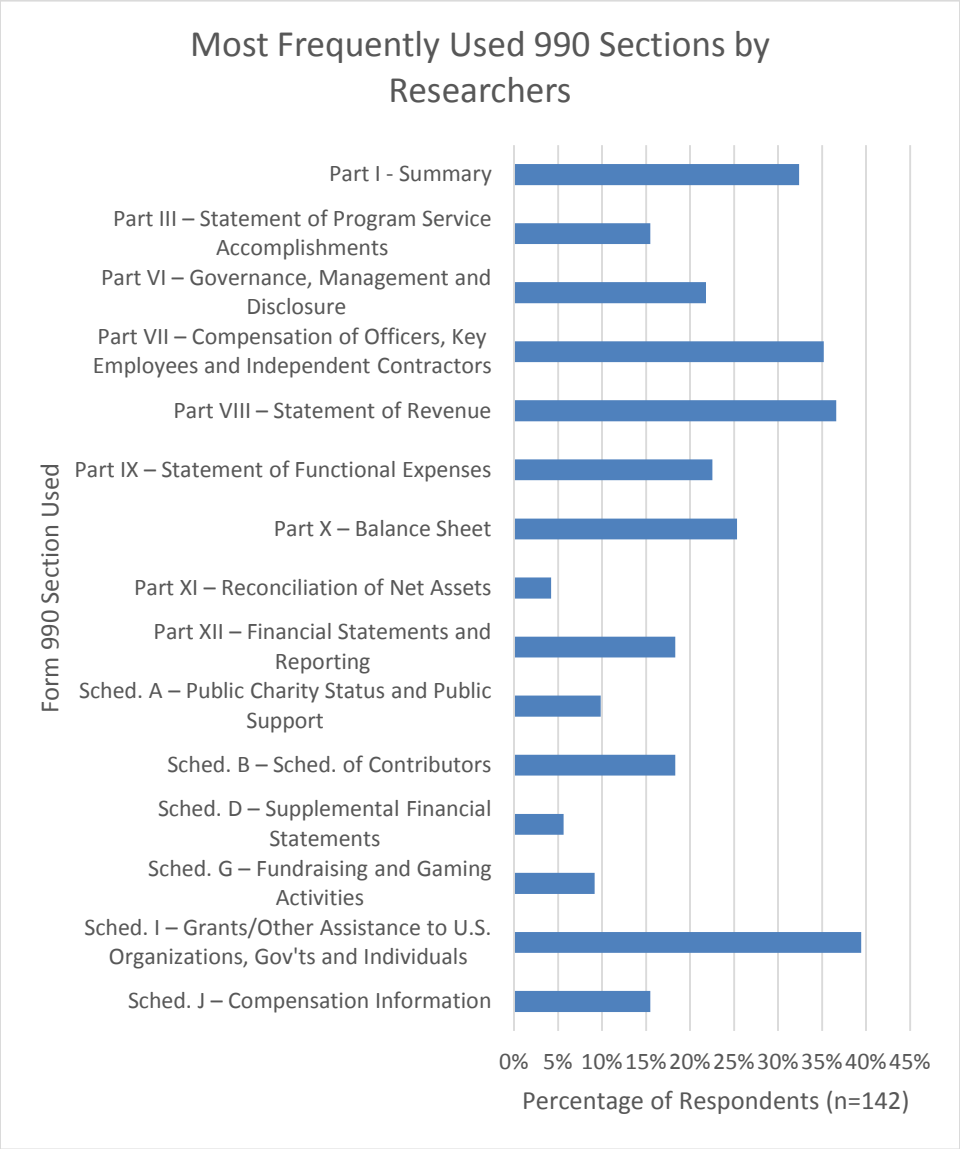
Of the 11 advisors to grantmakers who participated, 36.4 percent cited Part VII and 27.3 percent cited Part I as the sections of the Form 990 they use most.



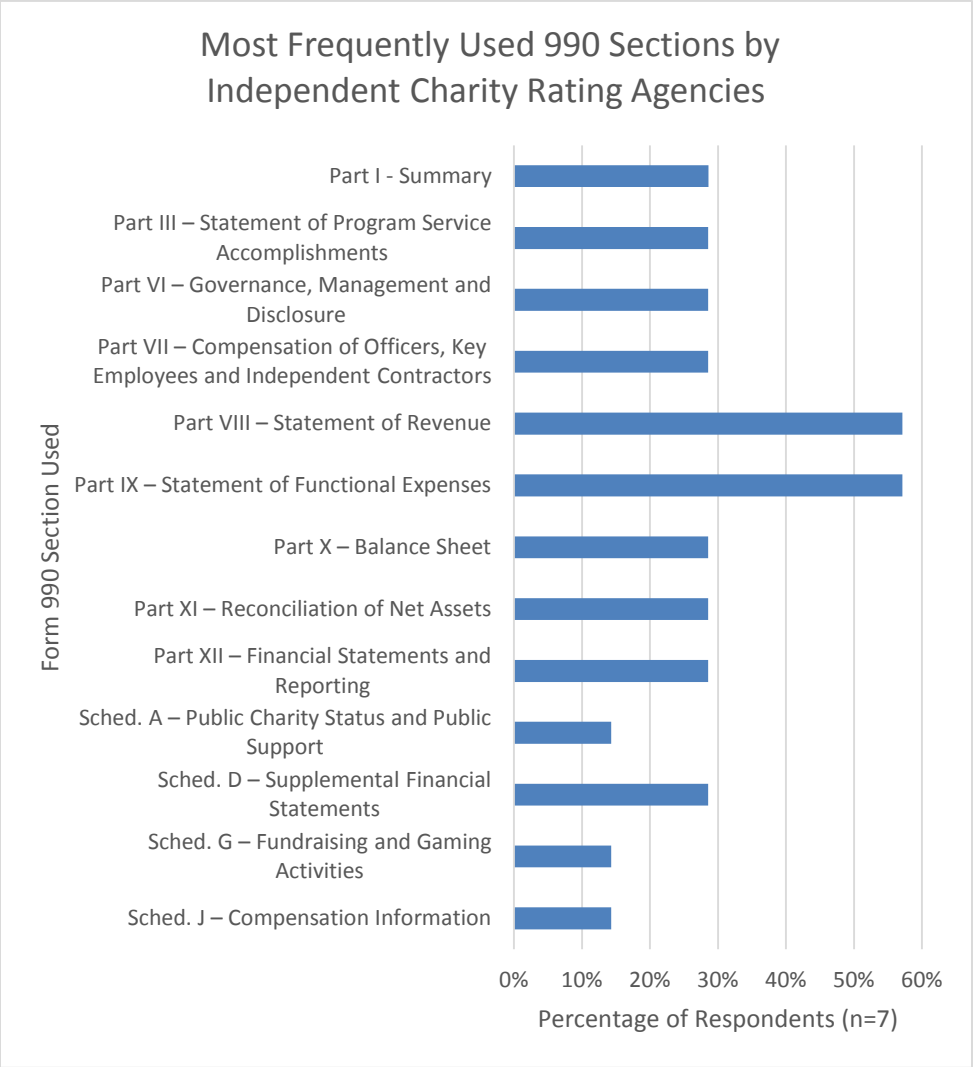
Nearly 40 percent of 233 attorneys and accountants who responded said they primarily use Parts VII and IX in their work, 30 percent use Part VIII, 31.3 percent use Part I, and 27 percent use Parts III and VI.



One hundred forty-two researchers responded to the survey. These individuals cited Schedule I (39.4% of respondents), and Parts VIII (36.6%), VII (35.2%), and I (32.4%) as the Form 990 sections they use most, followed by Parts X (25.4%), IX (22.5%) and VI (21.8%).



Nearly 60 percent of the seven responding independent charity rating agencies use Parts VIII and IX of the Form 990 in their work. Nearly 30 percent use Parts I, III, VI, VII, X, XI (Reconciliation of Net Assets) and XII and Schedule D (Supplemental Financial Statements).



d. Other survey comments and observations about the Form 990

Form 990 represents a unique and powerful opportunity for the 990 Village to find out about the purposes and activities – financial and missional – of filing organizations. The vast amount of data reported on the annual information return can allow various users to ascertain, dissect, and opine upon the activities, achievements, and financial workings of exempt organizations.

Certainly, a comprehensive review of an organization's annual Form 990 can provide insight and analysis that is not available from any other source. If the Form 990 is consistently and accurately completed by exempt organizations with a spirit of transparency, the form can become a standard of information that allows users great analytic power and understanding and a powerful platform for public communication.

The Form 990 reveals more about a nonprofit's operations than comparable tax forms do about individuals or private companies. As IRS instructions for Form 990 explain,

> Some members of the public rely on Form 990 or Form 990-EZ as their primary or sole source of information about a particular organization. How the public perceives an organization in such cases can be determined by information presented on its return. Therefore, the return must be complete, accurate, and fully describe the organization's programs and accomplishments. [63]

Several survey respondents offered positive comments about the Form 990. Comments included "The 990 is da bomb!" and "The Form 990 as it has evolved is an extraordinary forward step in improving the regulations of the [nonprofit] sector." Numerous responders stated that they would not delete nor change anything about the form.[64] Anecdotal comments concentrated on extoling the virtues of the form and that it was a "fabulous" planning tool for boards and management. Several commenters noted that it was an improvement over the pre-2008 versions of Form 990.

Taken as a whole, the Form 990 instructions contain a vast amount of instructional information about exempt organization purposes, activities and finances. The instructions are replete with examples – although survey responders continually asked for more – and the glossary (located in the instructions) is robust.

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[63] The Aspen Institute, "Information for Impact: Liberating Nonprofit Sector Data" (2nd Edition), Noveck and Goroff, p. 12

[64] It should be noted, however, that the survey contained a design flaw. In response to the question, "Are there any Parts/Schedules that you would like to see deleted from the Form 990? Select up to three," the ACT inadvertently did not provide an option for respondents to select "none" as an option. To compound this issue, the question required an answer in order to complete the survey. As a result, the responses from questions were largely discounted and not included in this report.

The “new” Form 990 does, however, contain a number of deficiencies. The instructions can be difficult to navigate and, due to minimal guidance in some areas, remain open to interpretation by filing organizations and their advisors.

Form 990, Part IV, Checklist of Required Schedules contains 38 instruction-intensive questions wherein a “Yes” answer requires the filing organization to complete a section of one of the Form 990’s sixteen “supporting schedules.” Survey comments on this part of the Form 990 centered upon its length and the complexity of the instructions.

Form 990, Part VI, Governance, Management, and Disclosure was a subject of much comment and debate in the redesigned form in the 2007 draft. Many argued that the IRS was not entitled to ask the questions contained therein. In fact, on the 2008 Form 990, the top of Part VI stated, “(Sections A, B, and C request information about policies not required by the Internal Revenue Code.)” The 2014 Form 990, Part VI, Section B has essentially the same disclaimer. The “Governance” section provoked comments in the survey with regard to whether filing organizations were actually following the policies and procedures in this section – even if they answered “Yes” to having policies in place. Because these questions were added for transparency reasons and because information regarding whether the provisions of the policies are followed seems beyond what could be easily gathered on the Form 990 and would be somewhat subjective, the ACT does not recommend that the IRS expand the current questions in this manner.

Overall, the “Compensation” section – Form 990, Part VII, Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors - received more survey comments than any other. Column F (Estimated amount of other compensation from the organization and related organizations) is designed to report “employee benefits.” The 2014 Form 990 instructions contain a grid that sets forth a menu of benefits and outlines where these benefits should be reported on Form 990, Part VII and/or Schedule J. This grid can be difficult to navigate and might benefit from varied and comprehensive examples. There appears to be a great deal of confusion about classifications, especially when it comes to “Officers” and “Key Employees.” Finally, several of the reviewers commented that they thought the compensation reporting thresholds should be lowered.

There is much discussion – as we saw in the survey responses and also heard from the interested groups with whom we met – with regard to the instructions for reporting government grants in Form 990, Part VIII. The application of this area of reporting can be difficult to discern and unclear – again resulting in inconsistent reporting among seemingly comparable organizations. Form 990, Part VIII, Line 1e is entitled, “Government grants.” However, the instructions also refer to instances where government grants may be more properly included on Form 990, Part VIII, Line 2

(Program Service Revenue). (To be fair, the Financial Accounting Standards Board (FASB) is currently wrestling with how government grants should be classified.)

The Form 990 instructions state,

> Whether a payment from a governmental unit is labeled a 'grant' or a 'contract' does not determine where the payment should be reported in Part VIII (Statement of Revenues). Rather, a grant or other payment from a governmental unit is reported here if its primary purpose is to enable the organization to provide a service to, or maintain a facility for, the direct benefit of the public rather than to serve the direct and immediate needs of the governmental unit. In other words, the payment is recorded on line 1e, Government Grants (contributions), if the general public receives the primary and direct benefit from the payment and any benefit to the governmental unit is indirect and insubstantial as compared to the public benefit.[65]

This distinction is not always easy to discern. The Form 990 instructions continue by listing examples of governmental grants and other payments that are treated as contributions and reported on line 1e as follows:

- Payments by a governmental unit for the construction or maintenance of library or museum facilities open to the public.
- Payments by a governmental unit to nursing homes to provide care to their residents (but not Medicare/Medicaid or similar payments made on behalf of the residents).
- Payments by a governmental unit to child placement or child guidance organizations under government programs to better serve children in the community.

The term "government grants" is not included in the Form 990 Glossary. The 990 Village might benefit greatly from a "redesigned" definition of "government grants" with tangible and detailed examples – rather than bullet points.

Ultimately, this confusion also tends to produce errors in the computation of some organizations' public support tests on Schedule A (Form 990), Part II and/or Part III.

Oft-mentioned in the anecdotal responses to the ACT's survey is that Form 990, Part IX, Functional Expenses, is fraught with erroneous and inconsistent reporting that results in users not being able to make reasonable comparisons of seemingly similar organizations. Much of the misinformation is provided by charities who are overly

[65] 2014 Form 990 Instructions, p. 37.

fixated on minimizing management and general expenses (Form 990, Part IX, Column C) and fundraising expenses (Form 990, Part IX, Column D) so as to keep those percentages low in comparison to Program service expenses (Form 990, Part IX, Column B). It would be a positive development for the various nonprofit industry groups (i.e. colleges and universities, hospitals, associations, and others) to take an active role in establishing procedures and guidelines for consistent functional expense reporting within their sub-sectors.

Form 990, Part X, Balance Sheet – although presented in a "Prior Year" / "Current Year" comparative format – does not lend itself well to computing important financial ratios. Current assets and liabilities are not readily discernible from long-term assets and liabilities. This can cause confusion when users are attempting to utilize Form 990 data to populate such standard ratios as the "current ratio."

Another area of confusion is in differences between Form 990 reporting and Generally Accepted Accounting Principles (GAAP). The Form 990 reporting requirements differ from GAAP in the areas of unrealized gains and losses; donated services and facilities; fundraising expenses; rental expenses; investment expenses; contributed marketable securities that are immediately sold; among other items. The return does contain reconciliations of these amounts - Schedule D (Form 990), Part XI, Reconciliation of Revenue per Audited Financial Statements With Revenue per Return and Part XII, Reconciliation of Expenses per Audited Financial Statements With Expenses per Return – however, organizations that obtain consolidated, audited financial statements (as indicated at Form 990, Part IV, Line 12b) have the option to forego completing the reconciliations on Schedule D. In the future, the IRS should consider collaborating with the American Institute of Certified Public Accountants (AICPA) and the FASB in making the Form 990 more closely conform with GAAP.

When filing organizations were asked if there was anything not included on the Form 990 that they wish were included, many responders requested the ability to add clearer information on in-kind donations and an estimate for volunteer services. Many appeared frustrated by their inability to present volunteer services and other in-kind service contributions in a meaningful manner on the Form 990 and in a way that provides a more "even playing field." (We note that currently the instructions to the Form 990 allow organizations to add this information to Part III, Statement of Program Service Accomplishments, but the form itself does not indicate this option. Schedule O would also offer space for an explanation of these items) More information on an organization's "impact" and "accomplishments" were cited as suggested additions to the Form 990, such as setting forth "information on accomplishing mission," having a "better way to show what the organization accomplished in that year," and "more information on the impact the charity is having."

There were not a great number of comments that concentrated on issues with the sixteen supporting schedules. There were a smattering of comments with respect to confusion with areas of Schedules F (Statement of Activities Outside of the United States), G (Supplemental Information Regarding Fundraising or Gaming Activities), I (Supplemental Information on Grants and Other Assistance to Organization, Governments, and Individuals in the United States), and M (Non-Cash Contributions). A slightly larger number of comments centered on Schedules L (Transactions with Interested Persons) and R (Related Organizations and Unrelated Partnerships) being "difficult to understand and difficult to prepare." Although the information is required by statute and regulations, Schedule B (List of Contributors) remains unpopular. A few responders said they felt that with "Supplemental information" sections being added to most schedules, Schedule O might be superfluous.

Respondents to the ACT's survey also frequently noted that the Form 990 is too long, too complicated, and the instructions are difficult to navigate. Many comments centered upon the possibility of making the form more organized and reducing duplication of reporting, suggesting that there are repetitive questions and a request for too much information ("need more focus on the first few pages," "make the document half the size," "too complicated for 'real people' to complete," and "too complicated for anyone beyond experts to use the 990 as a useful tool").

The Form 990 instructions and IRS training of its staff received comments as well, with filers noting that the "instructions are complex and contradictory," "simpler instructions are needed" and that "the instructions should be rewritten" in addition to requests for more examples. One filer requested that EO staff "be more available to answer questions," and another filer stated that he or she "can almost never find answers on the IRS website to 990 questions" but did not elaborate on what the questions might be. One survey participant, in providing many comments on nonprofit accountability and the importance of IRS reporting, stated, "I recommend someone evaluate the Form 990 and remove all pieces that do not actually serve the purpose of identifying bad actors and/or confirming that the nonprofit should maintain its nonprofit status." Query whether the IRS – and the entire 990 Village – needs all the information requested on Form 990.

e. Survey of IRS Exempt Organization Managers

In addition to the 1,869 survey participants from the general public, the ACT received 29 responses from IRS Exempt Organizations Division managers. The responses were anonymous and gave insight to the following questions:

- If all exempt organizations were required to electronically file Form 990-series returns, do you believe that this would negatively affect organizations?

- Based on your experience and conversations with IRS staff and the public, what Part/Schedule of the Form 990 do you feel is the most difficult to prepare? (Select one.)
- Are there any Parts/Schedules that you would like to see deleted from the Form 990? (Select up to three.)
- Is there anything not included on the Form 990 that you wish were included? (Comment)
- On a scale of 1 to 5, how effective is the Form 990 for communicating with the public about an organization's governance programs and operations? (5 being most effective)
- On a scale of 1 to 5, how does the Form 990 encourage responsible board governance and executive behavior? (5 being strongly encourages)
- Would you like to provide any other comments regarding the Form 990? (Comment)

Of the 29 IRS EO managers responding to the survey, 58.62% answered that "universal" electronic filing would not negatively affect organizations. In terms of which Part/Schedule is most difficult to prepare, Part I, Summary (13.79%), Schedule A, Public Charity Status and Public Support (10.34%), and Schedule C, Political Campaign and Lobbying Activities (6.90%) were the top three answers. Eight of 29 respondents (27.59%) said that they did not know.

In terms of the top three Parts/Schedules that the EO managers might want to see deleted from Form 990, none received 65.52% of the responses, Part I, Summary received 13.79%, and Part V, Statements Regarding Other IRS Filings and Tax Compliance received 6.90%.

Nine EO managers provided comments regarding whether there was any information not included on Form 990 that they wished were. These anecdotal comments included two comments on "group ruling" data (an idea for a "Group Ruling Supplement" and the thought that the parent could report information about subordinates on Form 990). An idea was floated about the Form 990 replacing the Form 1023 or Form 1024 applications. Other comments regarded a line item whereby organizations would be asked if they had any delinquent tax filings, foreign data, and enhanced reporting of related for-profit organizations.

With regard to how effective the Form 990 is for communicating with the public about an organization's governance, programs, and operations, 75.86% of EO managers believe the Form 990 rates a three or four on a scale of 1 to 5. In addition, 20.69% rated the form a one and 3.45% (1 of 29) gave a five rating. The overall average score was 3.03.

For the question of whether the Form 990 encourages responsible board governance and executive behavior, 41.38% of the EO managers rated it a three on the 1 to 5 scale. 31.03% gave a one rating, and 20.69% thought the form deserved a four. None of the EO mangers felt that the Form 990 deserved a five rating on this question. The overall average score was 2.52.

In response to the ACT's query about providing "any other comments" on Form 990, comments were provided by five EO managers who participated in the survey. This query brought comments that included having the officers and directors of the organization "certify" they have reviewed the return and concur with its filing and a comment regarding more close supervision of subordinates by the parent in a group ruling. Two of the comments were:

> "The Service would save a significant sum of money in resources and correspondence with the taxpayer if consistency checks were completed prior to filing the returns."
>
> "The Form 990 can be prepared and filed in such a manner to obfuscate poor governance without the use of outright false statements."

V. CONCLUSIONS AND RECOMMENDATIONS

Recommendation 1:

The IRS Exempt Organizations Division should support a Congressional mandate to require electronic filing of the Form 990 series and should also take interim steps to encourage and provide incentives for voluntary e-filing of the Form 990 series for exempt organizations that are not subject to the mandatory e-filing requirements. The IRS should recommend to the Department of Treasury the elimination of the $10 million asset threshold for electronic filing of the Form 990 found in the Code Section 6011 regulations.

Based on the ACT's discussions with stakeholder groups and from the results of the survey, there appears to be overwhelming support for an e-filing mandate for all tax-exempt organizations. Previously in this report, we have set out numerous reasons why both the IRS and the exempt organizations sector would benefit from mandatory e-filing. In both our conversations with Form 990 stakeholders and from the survey, we found abundant support in the community for all e-filing of the Form 990 series returns. The IRS should encourage and support a congressional mandate to amend Code Sections 6011(e) and 6033 to make electronic filing of the Form 990 series mandatory for all tax-exempt organizations. The extension of electronic filing to all exempt organizations could contain a phase-in of the requirement for smaller organizations who may need additional transitional time to prepare for efiling. The IRS should, however, take into

consideration remote and rural areas that may be lacking in the resources and capabilities to electronically file a Form 990 return.

Until such time as efiling of the Form 990 series is mandatory through an amendment to the Code, the IRS should encourage the Department of Treasury to eliminate the $10 million in assets limitation on mandatory electronic filing that is set forth in the Code Section 6011 regulations and to add this action item to the Priority Guidance Plan, as well as provide support for President Obama's proposal for universal e-filing by providing support for the benefits to the IRS and the sector that would arise from mandatory e-filing. Code Section 6011(e) states that taxpayers may not be required to electronically file unless they are required to file at least 250 returns during a calendar year. The statute does not place a minimum asset requirement on this restriction. In 2005, when the Department of Treasury promulgated the electronic filing regulations, it added the $10 million limitation for Form 990 filers to eliminate a perceived potential burden to smaller organizations that may not be able to comply at a reasonable cost with e-filing. In 2015, this perceived burden may not be completely eliminated in all cases, but most exempt organizations should have the capabilities, through its staff, volunteers and advisors, to e-file the Form 990. Thus, to increase e-filing, the IRS should encourage the Department of Treasury to eliminate, with a phase-in over two to three years, the $10 million asset size threshold for mandatory e-filing, which is not required by the Code. As previously described, President Obama's 2016 Revenue Proposals set forth a change to require electronic filing of the entire Form 990 series and for the IRS to make the forms available to the public in a machine-readable format in a timely manner. The proposal lists a number of advantages of e-filing, which can be supported and further honed by the IRS.

Although it does not represent a statistical sample, the results of the ACT's survey support that the 990 Village, with a minimal number of exceptions, favors electronic filing for all tax-exempt organizations. Less than two percent of the Form 990 filers and less than six percent of the Form 990-EZ filers responding to the survey indicated that electronically filing their information return would be overly burdensome to their organization. As noted, the Form 990-N filers are already required to e-file.

In addition to pushing for a Congressional mandate on e-filing, and, in the shorter term working with the Department of Treasury to change the regulations to eliminate the $10 million asset threshold for e-filing, the IRS should consider interim measures to provide incentives for organizations to voluntarily e-file their Forms 990. For example, the IRS should consider allowing an automatic six-month extension of time to file for those exempt organizations that will e-file their information returns by the extended due

date.[66] To enhance this effort, the IRS should aggressively promote the availability of e-filing to exempt organizations that are not required to do so and consider other appropriate incentives for e-filing. These measures would be in keeping with Code Section 6011(f), which states that Department of Treasury is authorized to promote the benefits of and encourage the use of electronic tax administration programs, as they become available, through the use of mass communications and other means.

We recognize that mandatory e-filing will require updates to the IRS computer systems to both handle the increase in the number of e-filed returns and to fully utilize and data-mine the additional data available to the IRS from the electronically filed returns. The IRS is in desperate need of a long overdue and significant technology upgrade. Upgrades should include systems and platforms in place for the forms themselves, the accompanying form instructions, e-filing receipt and dissemination and sharing of data. Resources are scarcer at the IRS than even a few years ago. Even so, we are hopeful that Congress, the administration and the public recognize the need for the IRS to update its technology systems to allow it to handle not only its tax administration tasks, but also its additional responsibilities that result from statutory and regulatory changes. Without such an investment in technology, the IRS is not in a position to change forms without significant cost, cannot easily share data with the public as required by *Public.Resource.org v. United States Internal Revenue Service*, and is not able to efficiently share information with state regulators under Section 6104, as amended by the PPA. In addition, the IRS must be dedicated to ensuring that its online e-filing systems are set up in a manner that are as secure as possible to avoid data breaches, given that nondisclosable information (such as Schedule B disclosures) and passwords would be part of the datasystem.

Recommendation 2:

The IRS Exempt Organizations Division should convene a task force comprised of representative stakeholders to determine which parts and schedules of the current Form 990 and related instructions should be updated, enhanced, and/or deleted in order to allow a more clear understanding, better accuracy, enhanced consistency of reporting by the various Form 990 filers.

The Form 990 is a very comprehensive and complex form. For the 2008 filing year, the IRS undertook a major overhaul of the Form 990. The ACT is not suggesting that the IRS needs to commence another massive redesign of the form, but instead seek ways

[66] This could be accomplished by adding a box on the Form 8868, Application for Extension of Time to File an Exempt Organization Return, to give an automatic six-month extension of time to an organization that agrees to e-file the Form 990 or 990-EZ. If the tax-exempt organization does not ultimately e-file, the extension would be treated as only a three-month extension and the organization would need to file Part II of Form 8868 to receive an additional (not automatic) three-month extension.

to revise the Form 990 and its instructions to best serve its compliance efforts and accomplish the intended transparency without overly burdening tax-exempt filing organizations. The IRS should look at the Form 990 in its entirety and ask itself, “Do we need to be requesting all of this information to meet our three stated goals of the redesign?” And if the answer to this question is “no” to any of the requested material and it is not otherwise helping the 990 Village, then the IRS should not request the information on the Form 990.

As noted previously, Form 990 represents a unique and powerful opportunity for the 990 Village to report, ascertain, dissect, and opine upon the activities, achievements, and financial workings of exempt organizations. The shear amount of data being collected by the IRS – and hopefully shared with states, foundations, researchers, and others – can provide insight and analysis that is not available from any other source.

Further, the Form 990 provides savvy exempt organizations with a unique marketing tool. Ensuring that Form 990, Part I (Summary) and Part III (Statement of Program Service Accomplishments) depict a positive and accurate story of an exempt organization can be vital in positioning the organization for grants, ratings, and public trust.

However, all the data in the world is not valuable unless it is accurate, consistent, and timely. The current Form 990 and supporting schedules contain line items that are not intuitive, data that is not designed to be comparable, and instructions that can be nebulous and difficult to master. While much of the Form 990 reporting and data is extremely valuable to the 990 Village, thoughtful clarifications, potential deletions, and additional examples in the instructions would be of great benefit to all users. As this task force is considering ways to make the Form 990 a more effective reporting tool and source of data and with the move toward web-based technology and customer education and outreach, might an on-line, interactive Form 990 – akin to Form i1023 – be a valuable tool for small and medium-sized filers?

In our in-person and telephone interviews and the survey, we received many observations on the Form 990, including comments that functional expenses, compensation, government grants, volunteer labor and in-kind donations, and reporting on related organizations caused much confusion and/or resulted in distorted or unused data, which are matters that the IRS and the task force should address. (These comments are summarized in the body of this report.) The IRS already receives formal comments from industry groups and, more informally, comments from individuals who contact the IRS with their observations and questions. This task force, however, would be a more diverse working group with representatives of all facets of the sector that would engage in meaningful conversations about the Form 990 with a focus on

improving its clarity and effectiveness. Precedence for this can be found in the IRS's Taxpayer Advocacy Panel (TAP), a federal advisory committee that listens to taxpayers, identifies major taxpayer concerns and makes recommendations for improving IRS service. The TAP provides a forum for taxpayers to raise concerns about IRS service and offer suggestions for improvement. The TAP reports annually to the Secretary of the Treasury, IRS Commissioner and National Taxpayer Advocate. The Office of the Taxpayer Advocate is an independent organization within the IRS that provides support for and oversight of the TAP.

On April 22, 2015, the Financial Accounting Standards Board (FASB) released a proposed Accounting Standards Update (ASU) intended to improve the information provided in nonprofit financial statements and notes to financial statements. The proposed ASU makes presentation changes to the statement of activities and net asset classification. The recommended task force should place on their initial agenda a discussion about coordinating the Form 990 reporting and these new GAAP financial statement elements.

In addition, the IRS, with input from the task force, should review the data collected by the Form 990 to determine if it is used by the IRS in its tax compliance efforts or is otherwise beneficial for transparency reasons. It is hoped that the task force recommended above will address and resolve these and other issues. This task force could be convened remotely and/or in conjunction with already-scheduled conferences and events, for cost-savings reasons. In the meantime as well as in the long-run, the IRS needs to provide better instructions and more education so that Form 990 reporting results in quality information that is useable by both the IRS and the public.

Recommendation 3:

The IRS should consider requesting additional information from Form 990-N filers. This will be especially important given the relatively new Form 1023-EZ application process, which will result in more recognized tax-exempt organizations that will not have had their activities specifically reviewed by the IRS and which will likely file a Form 990-N due to their smaller size. In addition, because filing a Form 990-N likely will be the filing organization's only contact with the IRS, the agency should engage in more education and outreach as part of the Form 990-N filing process.

The new generation of tax-exempt organizations receiving recognition of their tax-exempt status through the streamlined Form 1023-EZ application process (the "Gen EZ" filers) generally will have been subject to very little scrutiny of their proposed activities, purposes, board composition, and transactions in their formative stages. In addition, by

using the EZ certification process, these organization did not have contact with an IRS agent who may have provided helpful information on conducting the organization's activities or who may have questioned certain proposed activities or transactions. Many of these organizations will be filing a Form 990-N for their first several years of operation, if not perpetually. As a result, the IRS will be unable to glean anything from their information returns for purposes of reviewing their operations in later years. The GAO Report similarly notes that the IRS recognizes that this lack of information will bring challenges to the agency in identifying noncompliance issues for the Gen EZ filers.[67]

We note that the IRS already conducts pre-determination reviews to ensure organizations qualify for the 1023-EZ process and plans to conduct post-determination correspondence reviews with a statically valid sample of exempt organizations that filed a Form 1023-EZ. These correspondence reviews will focus on the operations of the exempt organizations.[68] The IRS already conducts pre-determination reviews on a random three percent of applicants to ensure organizations qualify for the 1023-EZ process.

We recommend that the IRS consider increasing the amount of information requested on the Form 990-N to give some indication of Form 990-N filers' activities and expenses. The Form 990-N filers include not only the Gen EZ members, but also other smaller tax-exempt organizations that may have been formed years ago and that never have been through the exercise of preparing and filing a Form 990 to ensure that they are meeting a necessary public support test, refraining from engaging in impermissible activities, and undertaking other diligence that the Form 990 preparation process necessarily entails.

In the questionnaire, we asked the Form 990-N filers if providing the total income and expenses of their organization to the IRS would be overly burdensome. Two-thirds of the Form 990-N filers answering this question responded that this disclosure of income and expenses would not overly burden their organization. This is just one example of the additional information that could be requested from Form 990-N filers. The IRS could also ask for information on the number of members of the organization's governing body and a brief statement of the organization's mission. As it is doing with a random, three percent selection of Form 1023-EZ applications, the IRS could ask information on the organization's assets, basis for exemption, transactions with related parties, or similar questions. The ACT believes that requesting more information with respect the Form 990-N would assist the IRS in its compliance efforts with these smaller

[67] GAO Report, page 34.
[68] Remarks of Sunita Lough, footnote 27, supra.

organizations and well as to make the organizations more accountable for their operations and financial results.

In addition to requesting more information regarding the Form 990-N, the ACT recommends that the IRS consider providing helpful information to these smaller exempt organizations when they are filing a Form 990-N. In most instances, the Form 990-N filers are in contact with the IRS at most annually, when they file the Form 990-N, and this contact is actually not directly with the IRS, but with a software provider, such as the Urban Institute, which facilitates the e-filing to the IRS. Typically, these smaller exempt organizations do not otherwise interact with the IRS. This (hopefully) annual contact is an opportunity for the IRS (through the software provider) to reach out to these organizations to provide information and resources on compliance with the tax laws as well as on organizational effectiveness. To the extent the IRS's contract with the software provider does not currently provide for additional interaction and information to these smaller exempt organizations, we recommend the contract be updated to address these matters.

For example, during the Form 990-N filing process, the organizations can be provided with reminders about the annual information return requirement, the requirements for their organizational documents, and information on maintaining tax-exempt status. After the Form 990-N is submitted, a "thank you" page could appear that alerts the filer to additional websites where they can turn for more information about exempt organizations. There could be a link to IRS information such as Publication 557, Tax-Exempt Status for Your Organization, a link to sign up to receive the IRS's EO Update, and a link to the educational resources available on the IRS website specifically designed to educate individuals who are new to the nonprofit and tax-exempt sector. In addition, these Form 990-N filers could be pointed toward information from other organizations, such as the Independent Sector's "33 Principles for Good Governance and Ethical Practice,"[69] the Standards for Excellence Institute's *Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector*,[70] and the National Council on Nonprofits' publication "Maintaining Tax Exempt Status."[71] Other educational information to be provided should also be considered.

[69] Available at https://www.independentsector.org/uploads/PrincipleResources/The_33_Principles.pdf.
[70] Available at http://www.standardsforexcellenceinstitute.org/dnn/TheCode.aspx.
[71] Available at http://www.councilofnonprofits.org/resources/resources-topic/administration-and-management/maintaining-tax-exempt-status

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Valentino Sabuco, Financial Awareness Foundation

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We would also like to thank everyone who participated in the ACT's Form 990 survey and to those individuals who disseminated access to the survey through their networks and contacts.

APPENDIX A

List of Groups Invited to Complete the Form 990 Survey

The organizations listed below disseminated invitations to participate in the survey to individuals in their networks

Alliance for Nonprofit Management
American Healthcare Lawyers Association, Tax and Finance Practice Group
American Institute of Certified Public Accountants (and the AICPA Tax Research Group)
Aspen Institute
Association of Business Administrators for Christian Colleges
Association of Fundraising Professionals
Association of Government Accountants
Better Business Bureau Wise Giving Alliance
BoardSource
Charity Navigator
Community Catalyst
Council of Foundations
Council of Nonprofits (which, in turn, invited State Associations (36) and Nonprofit Ally members of the Council of Nonprofits to encourage their members to participate in the survey)
Evangelical Council of Financial Accountability
Financial Awareness Foundation
Florida Institute of CPAs
Government Finance Officers Association
GuideStar
Grants Managers Network
Greater Washington Society of CPAs
Healthcare Finance Management Association
Independent Sector
National Association of College and University Business Officers
National Association of State Charity Officials
Tax Exempt/Government Entities Councils (Gulf Coast and Great Lakes Regions)
University of San Diego School of Leadership School of Leadership and Education Sciences
Urban Institute
Client and contacts lists of current ACT members

Featured Newsletters

EO Tax Journal, Paul Streckfus, editor

The invitation to participate was also shared with conference attendees at the following conferences and events

Advancement Northwest (AFP Washington Chapter) in January 2015
American Bar Association Conference in Houston, Texas, January 2015
Blackbaud Conference, Nashville, Tennessee, October 2014*
Greater Washington Society of CPAs, Washington, DC, December 2014*
Independent Sector, Seattle, Washington, November 2014*
National Association of State Charities Officials Public Day, October 2014*
Urban Institute, Increasing Philanthropy Through Policy and Practice, October 2014*

*The survey was mentioned at these conferences and events and attendees were encouraged to participate once the survey would become live in January 2015

The survey was also shared with members of the press, including the BNA Daily Tax Report, but we do not have documentation that it was disseminated or shared by these individuals and/or media outlets.

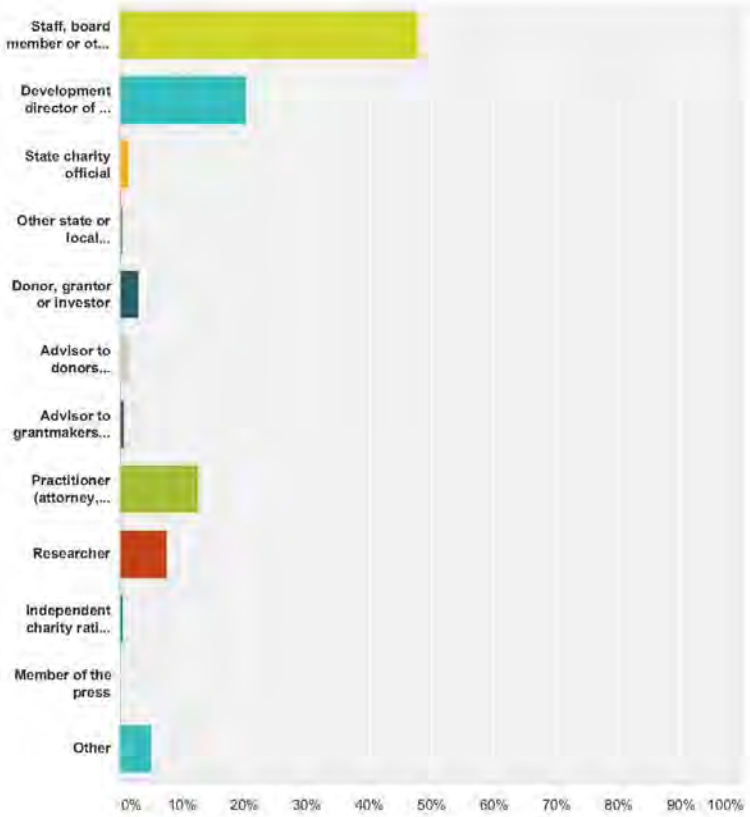
APPENDIX B

SURVEY RESULTS

Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Q1 I primarily use or review Forms 990 in the following capacity:

Answered: 1,869 Skipped: 0



Answer Choices	Responses	
Staff, board member or other representative of an organization that files a Form 990 (other than a development director – see below)	47.78%	893
Development director of an organization that files a Form 990	20.22%	378
State charity official	1.28%	24
Other state or local government official	0.37%	7
Donor, grantor or investor	2.94%	55
Advisor to donors (individuals and entities making gifts to nonprofits)	1.23%	23

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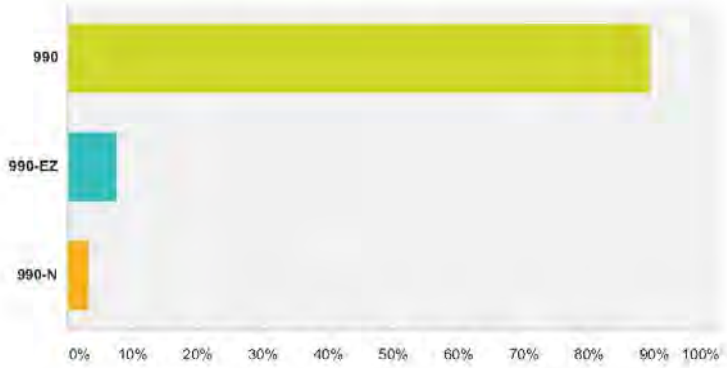
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Advisor to grantmakers (those making grants to nonprofit organizations)	0.59%	11
Practitioner (attorney, accountant)	12.47%	233
Researcher	7.60%	142
Independent charity rating agency	0.37%	7
Member of the press	0.05%	1
Other	5.08%	95
Total		1,869

Q2 What type of Form 990 does your organization file?

Answered: 1,217 Skipped: 652



Answer Choices	Responses	
990	89.40%	1,088
990-EZ	7.56%	92
990-N	3.04%	37
Total		1,217

Q3 Would providing your total revenues and total expenses on Form 990-N be overly burdensome to your organization?

Answered: 38 Skipped: 1,833

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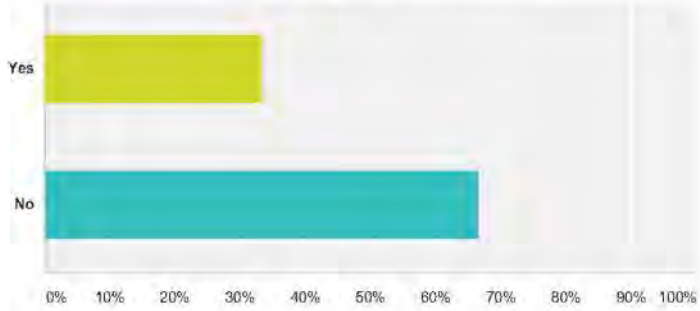
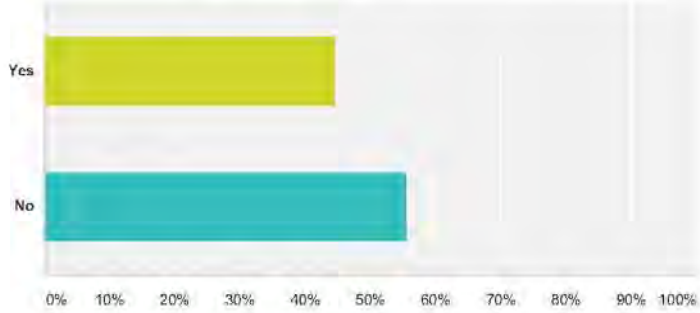
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Yes	33.33%	12
No	66.67%	24
Total		36

Q4 Does your organization have any paid staff?

Answered: 36 Skipped: 1,833



Answer Choices	Responses	
Yes	44.44%	16
No	55.56%	20
Total		36

Q5 When you need help completing Form 990-N where do you turn for that assistance?

Answered: 36 Skipped: 1,833

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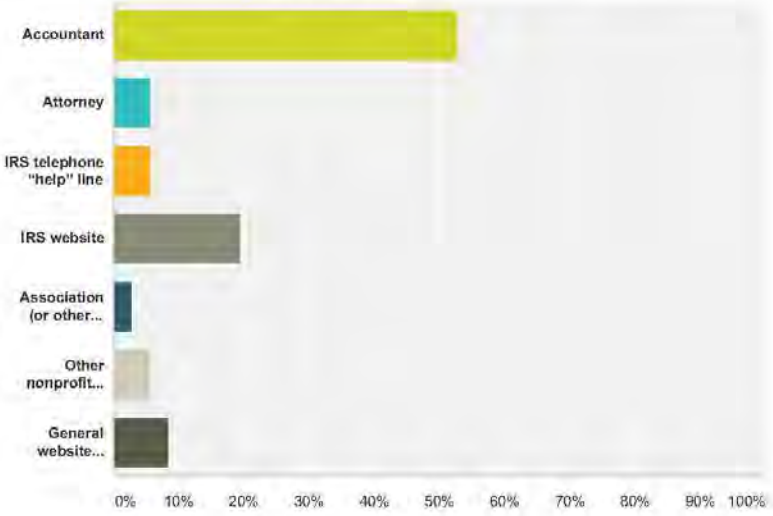
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Accountant	52.78%	19
Attorney	5.56%	2
IRS telephone "help" line	5.56%	2
IRS website	19.44%	7
Association (or other "industry organization)	2.78%	1
Other nonprofit organizations	5.56%	2
General website research	8.33%	3
Total		36

Q6 In what state is your nonprofit organization headquartered?

Answered: 36 Skipped: 1,833

Answer Choices	Responses	
Name:	0.00%	0
Company:	0.00%	0
Address:	0.00%	0
Address 2:	0.00%	0
City/Town:	0.00%	0
State:	100.00%	36

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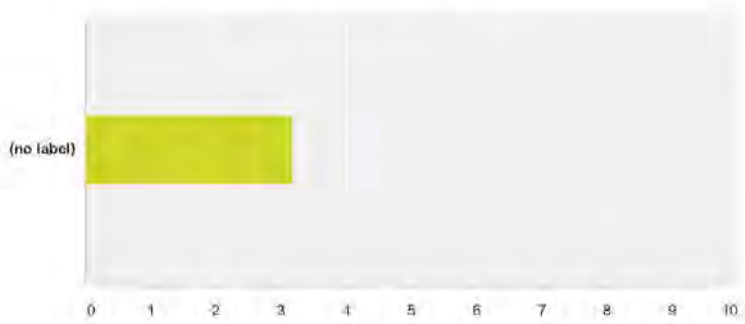
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

ZIP:	0.00%	0
Country:	0.00%	0
Email Address:	0.00%	0
Phone Number:	0.00%	0

Q7 On a scale from 1 to 5, does the Form 990-N encourage responsible board governance and executive behavior? (5 being strongly encourages)

Answered: 36 Skipped: 1,833

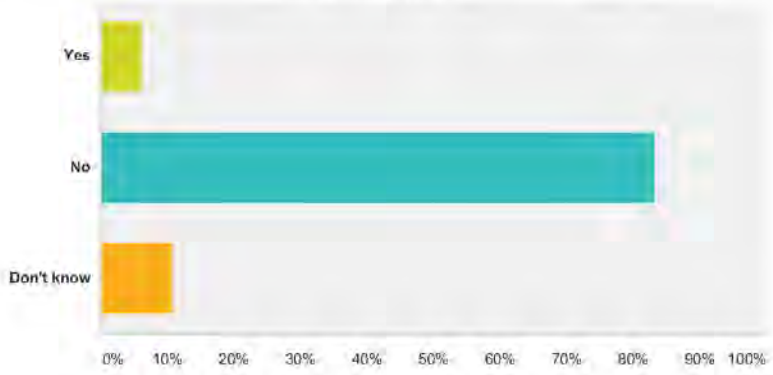


	1	2	3	4	5	Total	Weighted Average
(no label)	13.89% 5	8.33% 3	38.89% 14	25.00% 9	13.89% 5	36	3.17

Q8 If you were required to electronically file a Form 990 EZ, would this negatively affect your organization?

Answered: 84 Skipped: 1,785

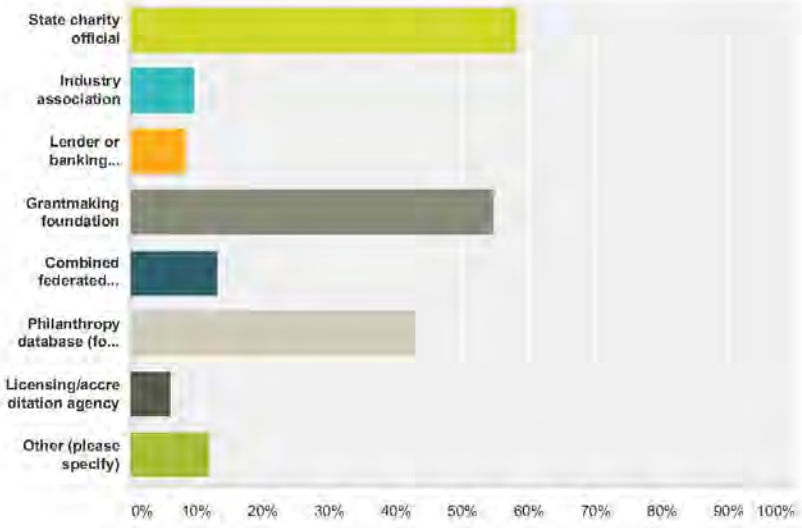
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Yes	5.95%	5
No	83.33%	70
Don't know	10.71%	9
Total		84

Q9 Other than filing the Form 990-EZ with the IRS, where else do you submit a copy of the Form 990-EZ? Please check all that apply.

Answered: 84 Skipped: 1,765



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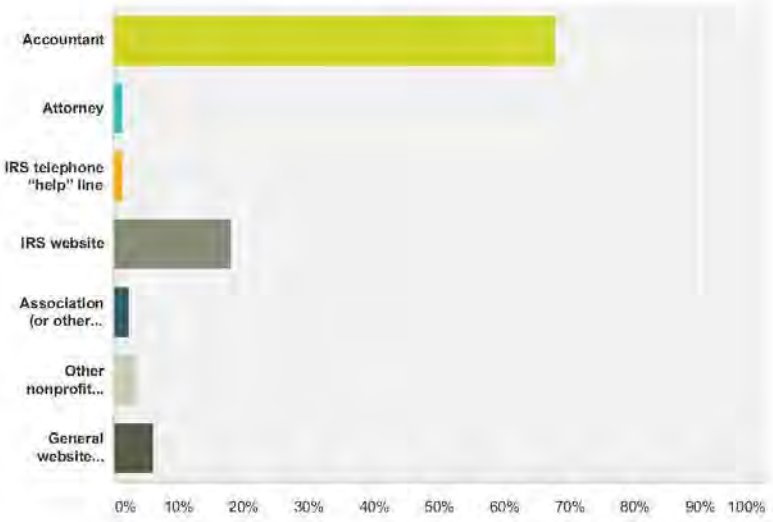
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Answer Choices	Responses	
State charity official	58.33%	49
Industry association	9.52%	8
Lender or banking institution	8.33%	7
Grantmaking foundation	54.76%	46
Combined federated campaign (includes CFC, United Way and others)	13.10%	11
Philanthropy database (for example, GuideStar)	42.86%	36
Licensing/accreditation agency	5.95%	5
Other (please specify)	11.90%	10
Total Respondents: 84		

Q10 When you need help completing Form 990-EZ where do you turn for that assistance?

Answered: 84 Skipped: 1,783



Answer Choices	Responses	
Accountant	67.86%	57
Attorney	1.19%	1
IRS telephone "help" line	1.19%	1
IRS website	17.86%	15

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Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Association (or other "industry organization)	2.38%	2
Other nonprofit organizations	3.57%	3
General website research	5.95%	5
Total		84

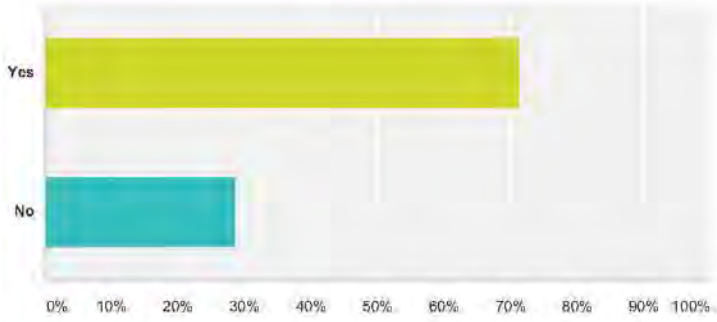
Q11 On a scale from 1 to 5, does the Form 990-EZ encourage responsible board governance and executive behavior? (5 being strongly encourages)

Answered: 84 Skipped: 1,785

	1	2	3	4	5	Total	Weighted Average
(no label)	5.95% 5	9.52% 8	40.48% 34	29.76% 25	14.29% 12	84	3.37

Q12 Does your organization have any paid staff?

Answered: 84 Skipped: 1,785



Answer Choices	Responses

Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Yes	71.43%	60
No	28.57%	24
Total		84

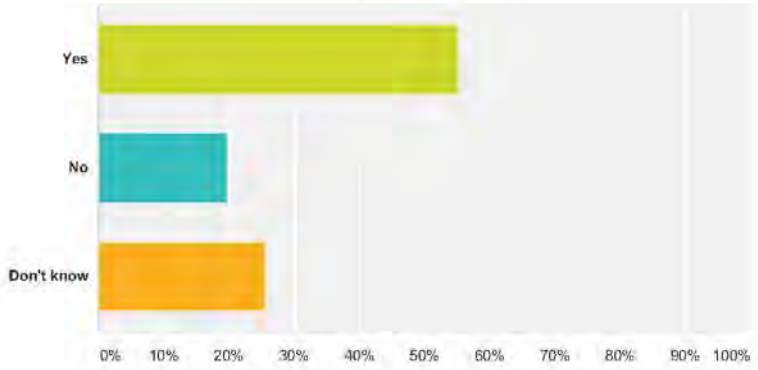
Q13 In what state is your nonprofit organization headquartered?

Answered: 84 Skipped: 1,785

Answer Choices	Responses	
Name:	0.00%	0
Company:	0.00%	0
Address:	0.00%	0
Address 2:	0.00%	0
City/Town:	0.00%	0
State:	100.00%	84
ZIP:	0.00%	0
Country:	0.00%	0
Email Address:	0.00%	0
Phone Number:	0.00%	0

Q14 Do you file the Form 990 electronically?

Answered: 1,070 Skipped: 799



Answer Choices	Responses	
Yes	55.05%	589

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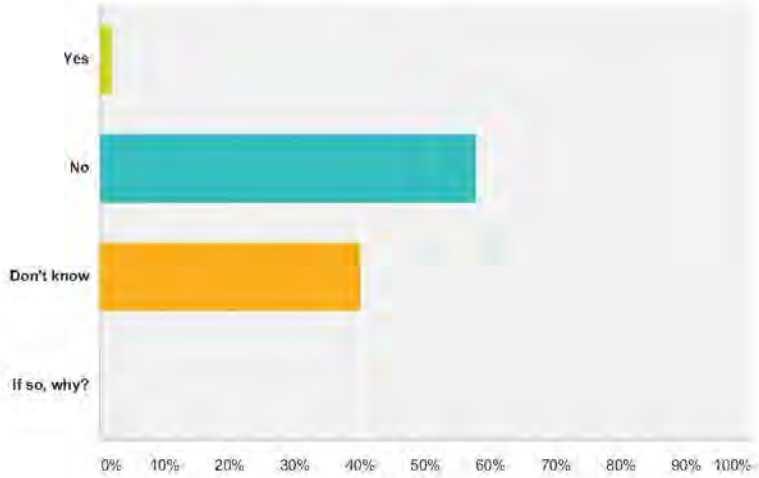
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

No	19.53%	209
Don't know	25.42%	272
Total		1,070

Q15 If you were required to electronically file a Form 990, would this negatively affect your organization?

Answered: 468 Skipped: 1,401



Answer Choices	Responses	
Yes	1.92%	9
No	57.91%	271
Don't know	40.17%	188
If so, why?	0.00%	0
Total		468

Q16 Do you file the Form 990 electronically on a voluntary basis or is your organization required to do so?

Answered: 541 Skipped: 1,328

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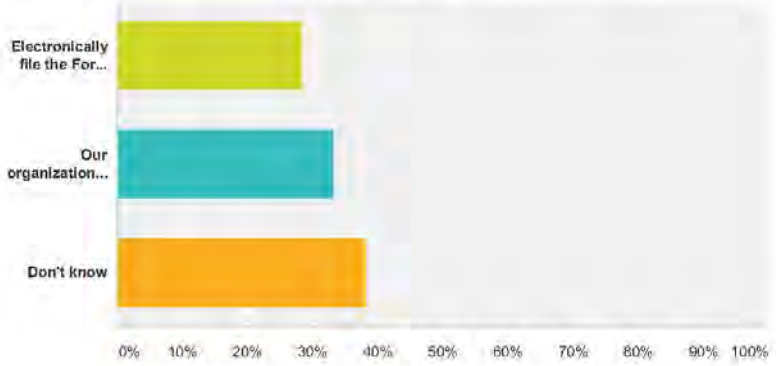
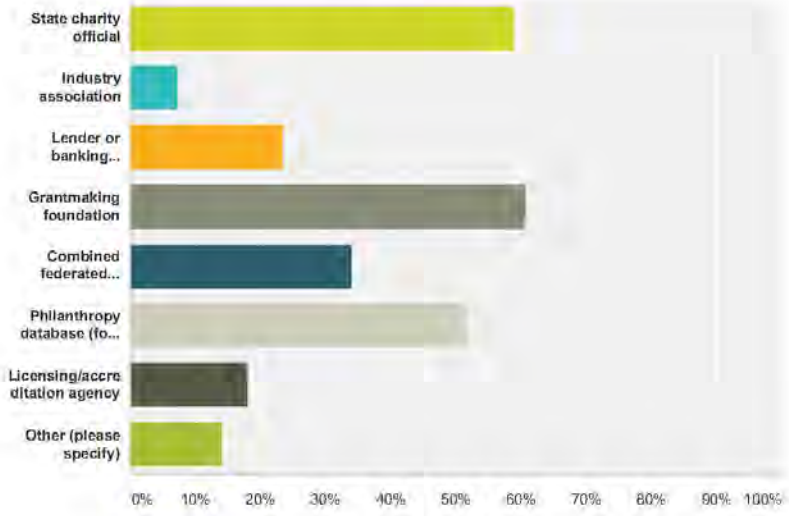
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Electronically file the Form 990 voluntarily	28.47%	154
Our organization is required to electronically file the Form 990	33.27%	180
Don't know	38.26%	207
Total		541

Q17 Other than filing the Form 990 with the IRS, where else do you submit or send a copy of the Form 990? Please check all that apply.

Answered: 732 Skipped: 1,137



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Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Answer Choices	Responses	
State charity official	58.88%	431
Industry association	7.24%	53
Lender or banking institution	23.36%	171
Grantmaking foundation	60.66%	444
Combined federated campaign (includes CFC, United Way and others)	34.02%	249
Philanthropy database (for example, GuideStar)	51.64%	378
Licensing/accreditation agency	18.03%	132
Other (please specify)	13.93%	102
Total Respondents: 732		

Q18 On a scale of 1 to 5, how effective is the Form 990 for communicating with the public about your organization's governance, programs and operations? (5 being most effective)

Answered: 732 Skipped: 1,137

	1	2	3	4	5	Total	Weighted Average
(no label)	7.24% 53	24.18% 177	41.94% 307	21.31% 156	5.33% 39	732	2.80

Q19 What Part/Schedule of the Form 990 does your organization find the most difficult to prepare, including gathering the appropriate data? Select one.

Answered: 732 Skipped: 1,137

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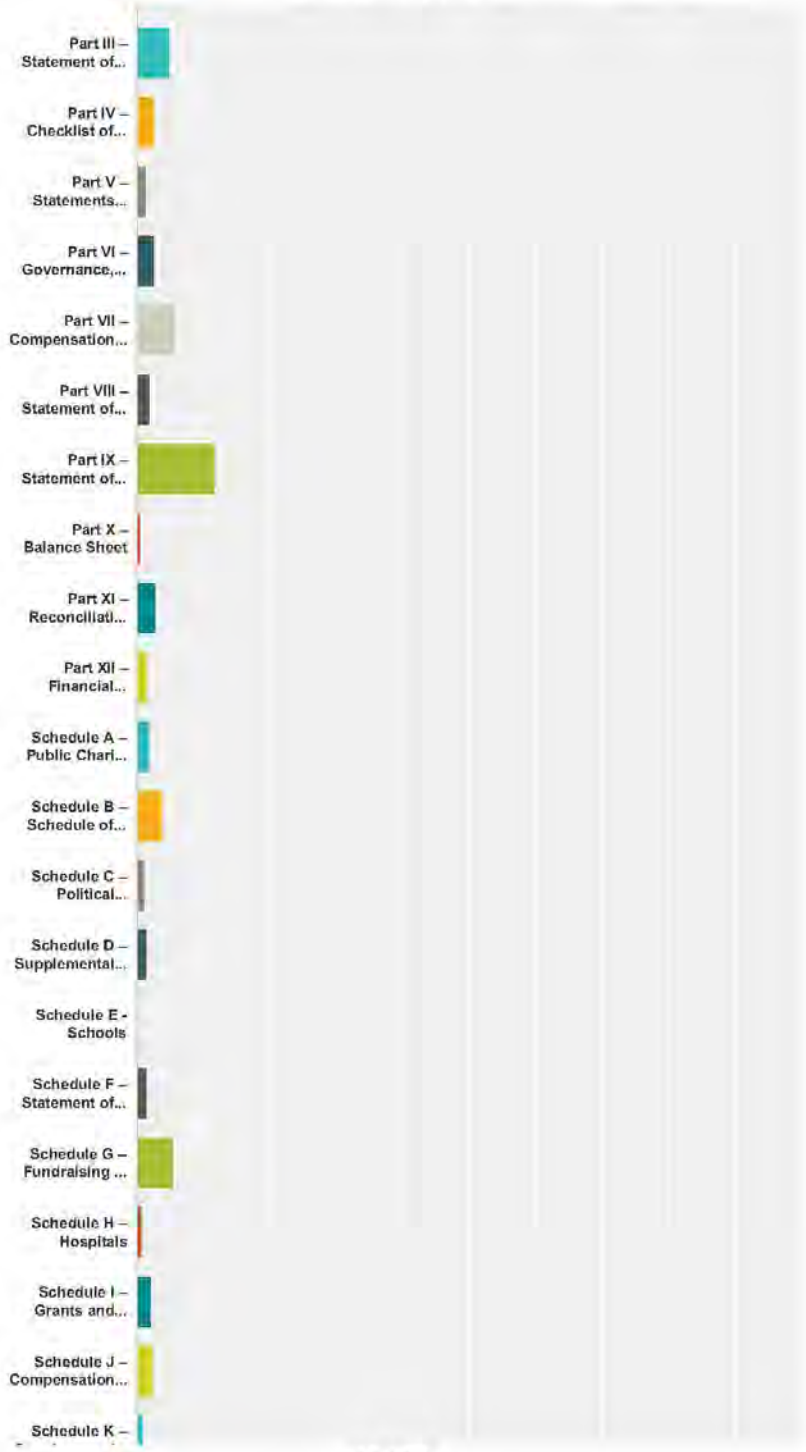
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



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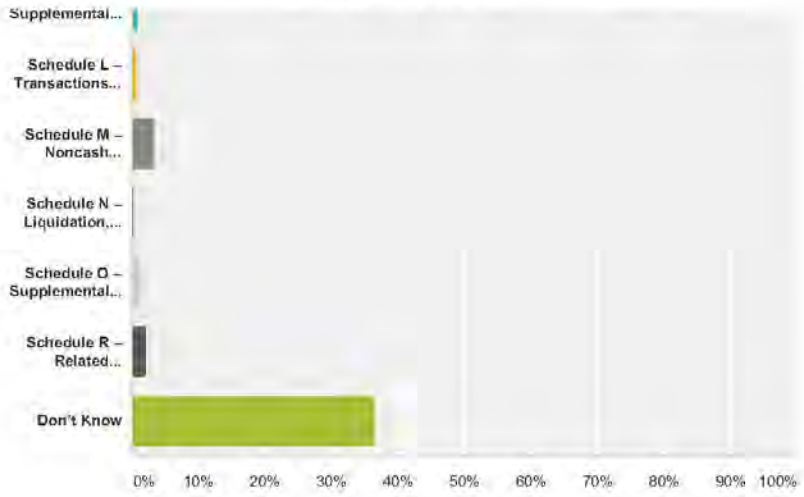
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Part I - Summary	0.41%	3
Part III – Statement of Program Service Accomplishments	4.78%	35
Part IV – Checklist of Required Schedules	2.60%	19
Part V – Statements Regarding Other IRS Filings and Tax Compliance	1.23%	9
Part VI – Governance, Management and Disclosure	2.60%	19
Part VII – Compensation of Officers, Directors, Key Employees, Highest Compensated Employees, and Independent Contractors	5.74%	42
Part VIII – Statement of Revenue	1.78%	13
Part IX – Statement of Functional Expenses	11.61%	85
Part X – Balance Sheet	0.41%	3
Part XI – Reconciliation of Net Assets	2.73%	20
Part XII – Financial Statements and Reporting	1.37%	10
Schedule A – Public Charity Status and Public Support	1.78%	13
Schedule B – Schedule of Contributors	3.69%	27
Schedule C – Political Campaign and Lobbying Activities	0.96%	7
Schedule D – Supplemental Financial Statements	1.50%	11
Schedule E - Schools	0.14%	1
Schedule F – Statement of Activities Outside the United States	1.50%	11
Schedule G – Fundraising and Gaming Activities	5.33%	39
Schedule H – Hospitals	0.68%	5

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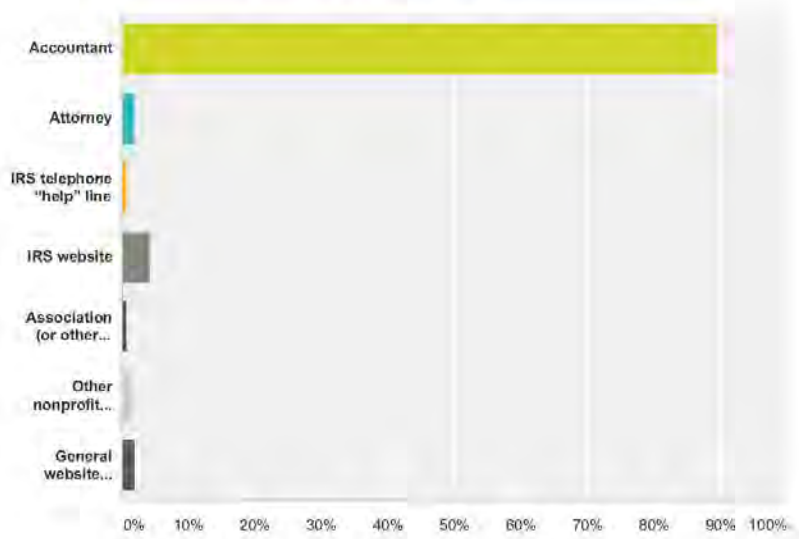
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Schedule I – Grants and Other Assistance to Organizations, Governments and Individuals in the U.S.	2.05%	15
Schedule J – Compensation Information	2.32%	17
Schedule K – Supplemental Information on Tax-Exempt Bonds	0.82%	6
Schedule L – Transactions with Interested Persons	0.55%	4
Schedule M – Noncash Contributions	3.28%	24
Schedule N – Liquidation, Termination, Dissolution or Significant Disposition of Assets	0.27%	2
Schedule O – Supplemental Information	1.23%	9
Schedule R – Related Organization and Unrelated Partnerships	2.05%	15
Don't Know	36.61%	268
Total		732

Q20 When you need help completing Form 990 where do you primarily turn for that assistance?

Answered: 732 Skipped: 1,137



Answer Choices	Responses	
Accountant	89.48%	655
Attorney	1.91%	14
IRS telephone "help" line	0.55%	4

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Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

IRS website	4.23%	31
Association (or other "industry organization)	0.68%	5
Other nonprofit organizations	1.37%	10
General website research	1.78%	13
Total		732

Q21 On a scale from 1 to 5, does the Form 990 encourage responsible board governance and executive behavior? (5 being strongly encourages)

Answered: 732 Skipped: 1,137

	1	2	3	4	5	Total	Weighted Average
(no label)	9.29% 68	20.49% 150	34.56% 253	26.09% 191	9.56% 70	732	3.06

Q22 Are there any Parts/Schedules that you would like to see deleted from the Form 990? Select up to three.

Answered: 732 Skipped: 1,137

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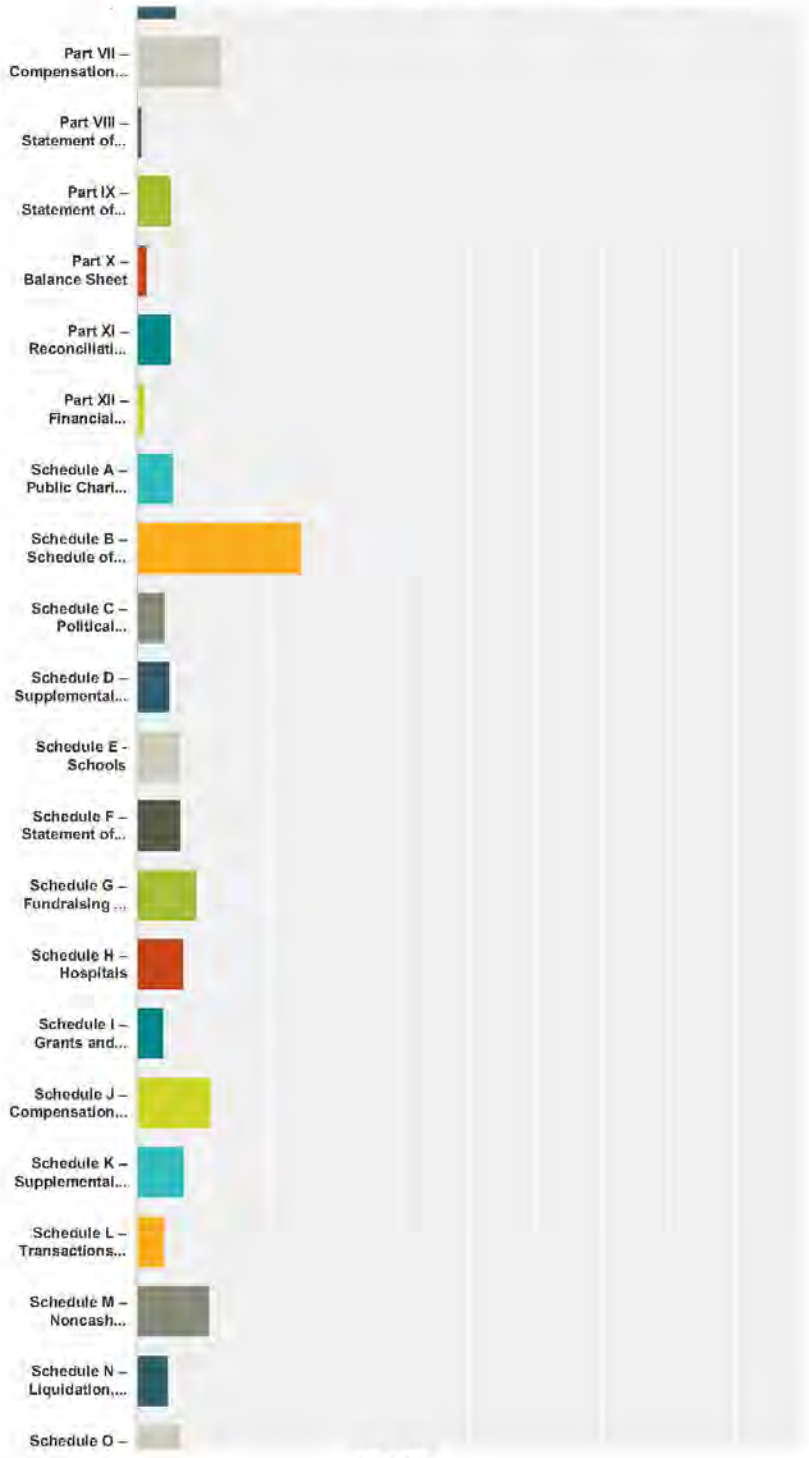
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



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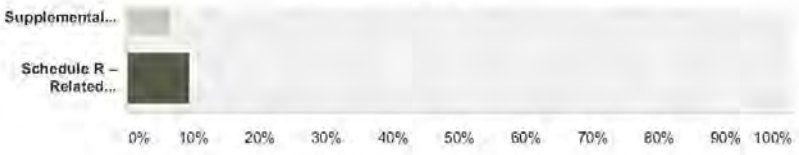
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Part I - Summary	2.19%	16
Part III – Statement of Program Service Accomplishments	3.69%	27
Part IV – Checklist of Required Schedules	8.20%	60
Part V – Statements Regarding Other IRS Filings and Tax Compliance	6.15%	45
Part VI – Governance, Management and Disclosure	5.87%	43
Part VII – Compensation of Officers, Directors, Key Employees, Highest Compensated Employees, and Independent Contractors	12.70%	93
Part VIII – Statement of Revenue	0.55%	4
Part IX – Statement of Functional Expenses	4.92%	36
Part X – Balance Sheet	1.37%	10
Part XI – Reconciliation of Net Assets	5.05%	37
Part XII – Financial Statements and Reporting	1.09%	8
Schedule A – Public Charity Status and Public Support	5.33%	39
Schedule B – Schedule of Contributors	24.73%	181
Schedule C – Political Campaign and Lobbying Activities	4.10%	30
Schedule D – Supplemental Financial Statements	4.78%	35
Schedule E - Schools	6.42%	47
Schedule F – Statement of Activities Outside the United States	6.42%	47
Schedule G – Fundraising and Gaming Activities	8.88%	65
Schedule H – Hospitals	6.83%	50
Schedule I – Grants and Other Assistance to Organizations, Governments and Individuals in the U.S.	3.96%	29
Schedule J – Compensation Information	11.07%	81
Schedule K – Supplemental Information on Tax-Exempt Bonds	7.10%	52
Schedule L – Transactions with Interested Persons	3.96%	29
Schedule M - Noncash Contributions	10.93%	80
Schedule N – Liquidation, Termination, Dissolution or Significant Disposition of Assets	4.51%	33
Schedule O – Supplemental Information	6.42%	47
Schedule R – Related Organization and Unrelated Partnerships	9.43%	69

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Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

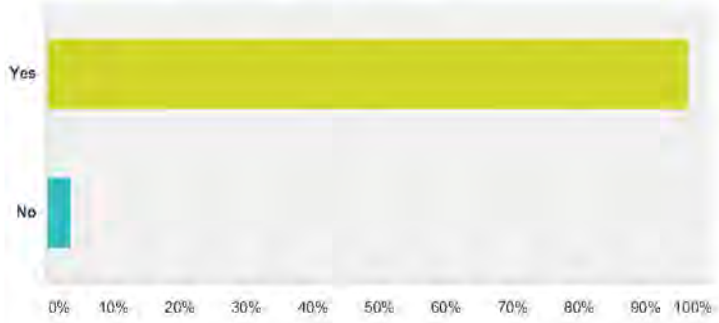
Total Respondents: 732

Q23 Is there anything not included on the Form 990 that you wish were included?

Answered: 112 Skipped: 1,757

Q24 Does your organization have any paid staff?

Answered: 732 Skipped: 1,137



Answer Choices	Responses	
Yes	96.45%	706
No	3.55%	26
Total		732

Q25 What was your organization's revenue for its most recently completed fiscal year?

Answered: 732 Skipped: 1,137

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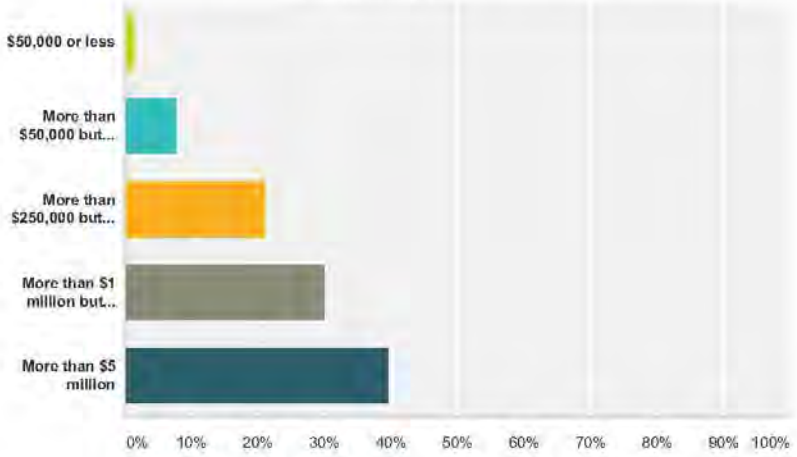
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
$50,000 or less	1.37%	10
More than $50,000 but less than $250,000	7.79%	57
More than $250,000 but less than $1 million	21.04%	154
More than $1 million but less than $5 million	30.05%	220
More than $5 million	39.75%	291
Total		732

Q26 In what state is your nonprofit organization headquartered?

Answered: 732 Skipped: 1,127

Answer Choices	Responses	
Name:	0.00%	0
Company:	0.00%	0
Address:	0.00%	0
Address 2:	0.00%	0
City/Town:	0.00%	0
State:	100.00%	732
ZIP:	0.00%	0
Country:	0.00%	0
Email Address:	0.00%	0

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Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Phone Number:	0.00%	0

Q27 Would you like to provide any other comments regarding the Form 990?

Answered: 167 Skipped: 1,702

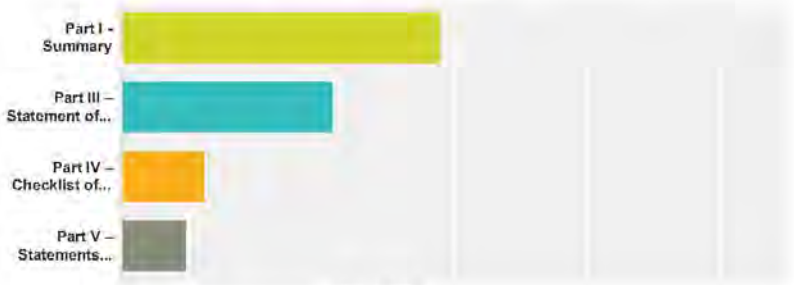
Q28 On a scale of 1 to 5, how effective is the Form 990 for communicating with the public about an organization's governance, programs and operations? (5 being most effective)

Answered: 399 Skipped: 1,470

	1	2	3	4	5	Total	Weighted Average
(no label)	4.51% 18	13.28% 53	43.11% 172	32.08% 128	7.02% 28	399	3.24

Q29 In your capacity as a reviewer of the Form 990, which Parts/Schedules of the Form 990 do you typically review? Select up to three.

Answered: 399 Skipped: 1,470



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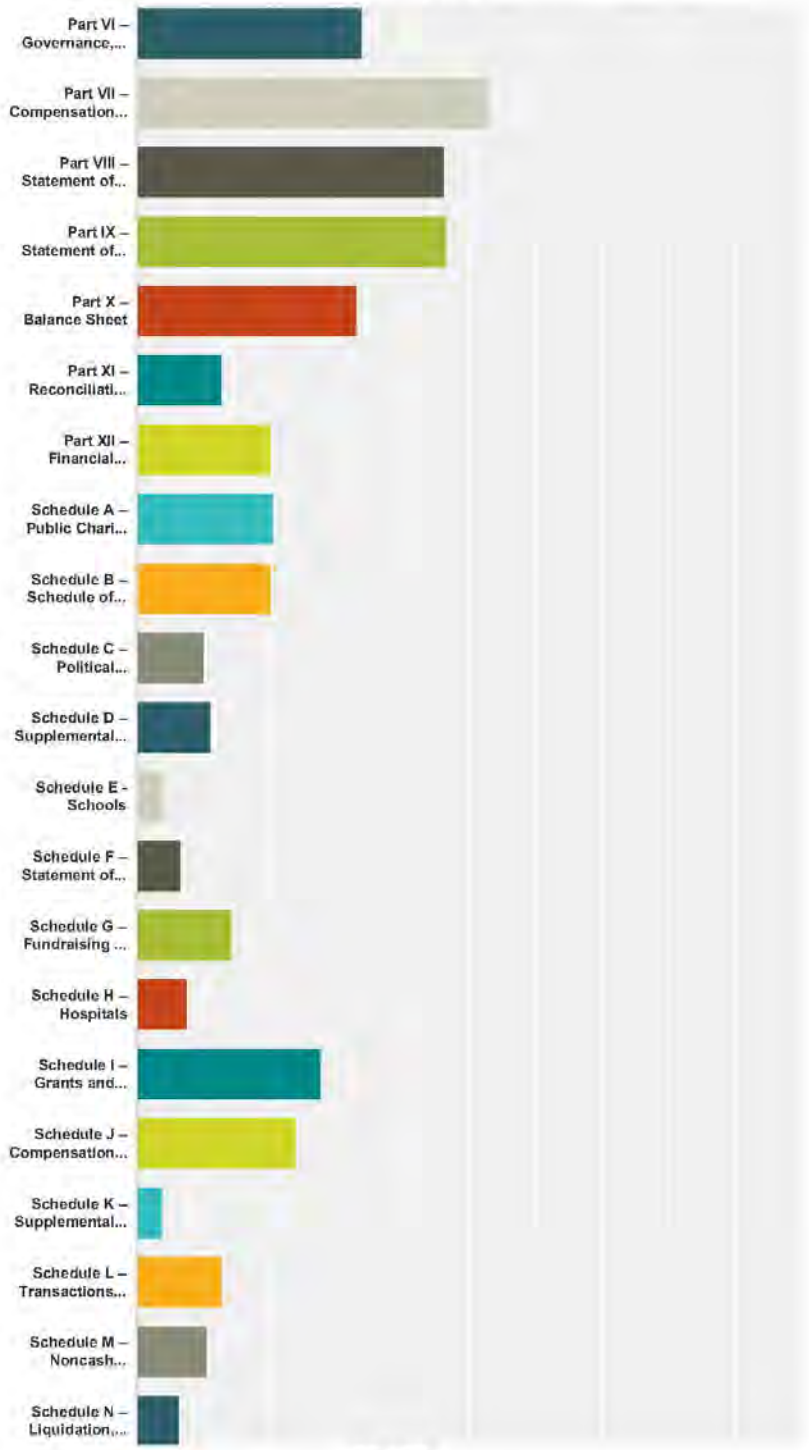
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



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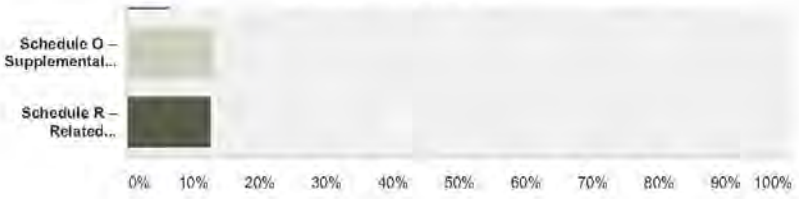
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Part I - Summary	47.87%	191
Part III – Statement of Program Service Accomplishments	31.83%	127
Part IV – Checklist of Required Schedules	12.28%	49
Part V – Statements Regarding Other IRS Filings and Tax Compliance	9.52%	38
Part VI – Governance, Management and Disclosure	33.83%	135
Part VII – Compensation of Officers, Directors, Key Employees, Highest Compensated Employees, and Independent Contractors	52.88%	211
Part VIII – Statement of Revenue	46.12%	184
Part IX – Statement of Functional Expenses	46.62%	186
Part X – Balance Sheet	33.08%	132
Part XI – Reconciliation of Net Assets	12.78%	51
Part XII – Financial Statements and Reporting	20.05%	80
Schedule A – Public Charity Status and Public Support	20.55%	82
Schedule B – Schedule of Contributors	20.05%	80
Schedule C – Political Campaign and Lobbying Activities	10.03%	40
Schedule D – Supplemental Financial Statements	11.03%	44
Schedule E - Schools	4.01%	16
Schedule F – Statement of Activities Outside the United States	6.52%	26
Schedule G – Fundraising and Gaming Activities	14.29%	57
Schedule H – Hospitals	7.52%	30
Schedule I – Grants and Other Assistance to Organizations, Governments and Individuals in the U.S.	27.57%	110
Schedule J – Compensation Information	23.81%	95
Schedule K – Supplemental Information on Tax-Exempt Bonds	3.76%	15
Schedule L – Transactions with Interested Persons	12.78%	51
Schedule M – Noncash Contributions	10.53%	42
Schedule N – Liquidation, Termination, Dissolution or Significant Disposition of Assets	6.27%	25
Schedule O – Supplemental Information	13.03%	52

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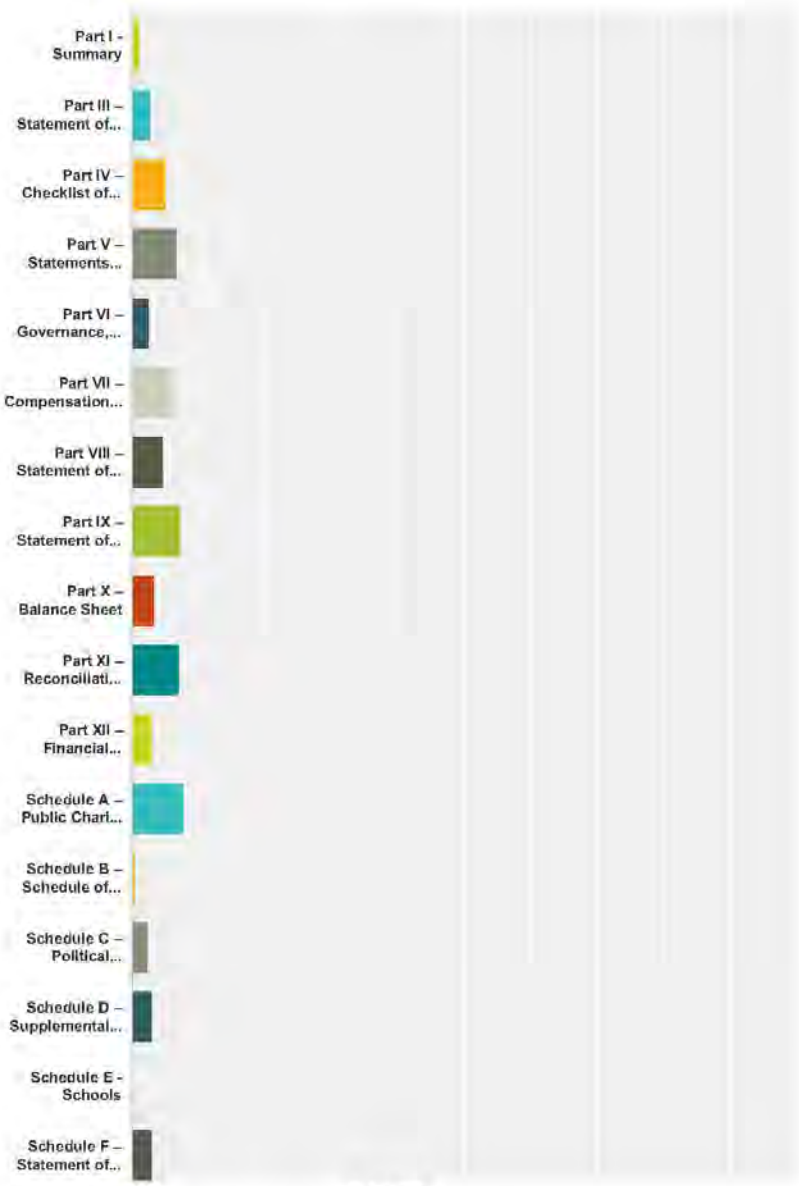
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Schedule R – Related Organization and Unrelated Partnerships	12.53%	50
Total Respondents: 399		

Q30 What Part/Schedule of the Form 990 do you find the information reported the most difficult to understand? Select one.

Answered: 399 Skipped: 1,470



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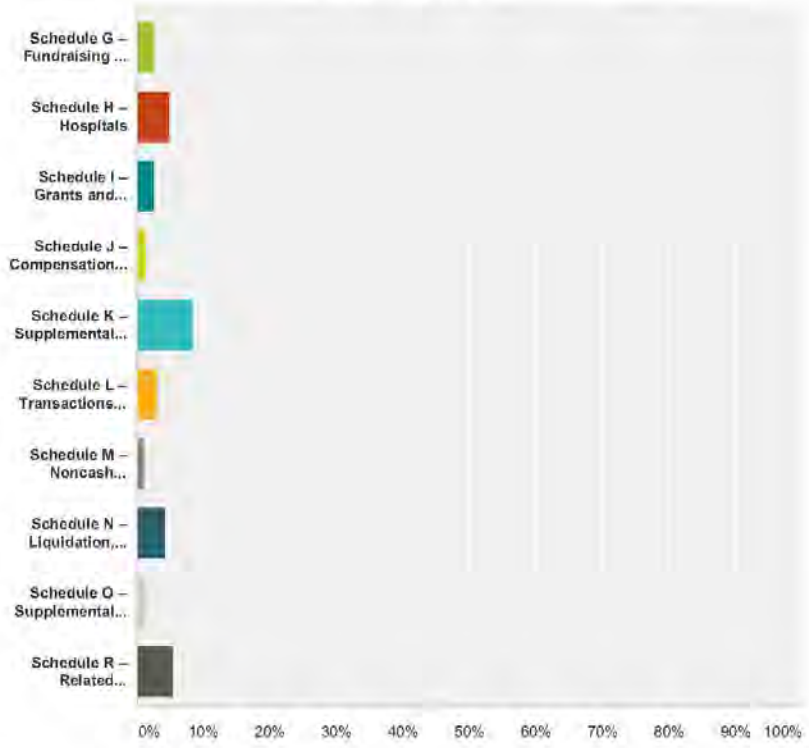
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Part I - Summary	1.00%	4
Part III – Statement of Program Service Accomplishments	2.76%	11
Part IV – Checklist of Required Schedules	5.01%	20
Part V – Statements Regarding Other IRS Filings and Tax Compliance	6.77%	27
Part VI – Governance, Management and Disclosure	2.51%	10
Part VII – Compensation of Officers, Directors, Key Employees, Highest Compensated Employees, and Independent Contractors	6.02%	24
Part VIII – Statement of Revenue	4.51%	18
Part IX – Statement of Functional Expenses	7.27%	29
Part X – Balance Sheet	3.26%	13
Part XI – Reconciliation of Net Assets	7.02%	28
Part XII – Financial Statements and Reporting	3.01%	12
Schedule A – Public Charity Status and Public Support	7.77%	31
Schedule B – Schedule of Contributors	0.50%	2

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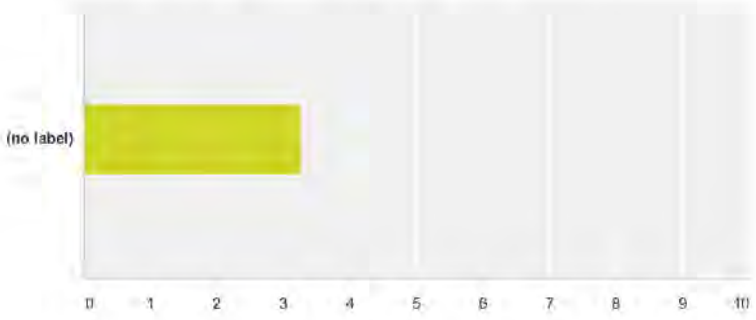
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Schedule C – Political Campaign and Lobbying Activities	2.26%	9
Schedule D – Supplemental Financial Statements	3.01%	12
Schedule E - Schools	0.00%	0
Schedule F – Statement of Activities Outside the United States	3.01%	12
Schedule G – Fundraising and Gaming Activities	2.51%	10
Schedule H – Hospitals	4.76%	19
Schedule I – Grants and Other Assistance to Organizations, Governments and Individuals in the U.S.	2.51%	10
Schedule J – Compensation Information	1.25%	5
Schedule K – Supplemental Information on Tax-Exempt Bonds	8.27%	33
Schedule L – Transactions with Interested Persons	3.01%	12
Schedule M – Noncash Contributions	1.00%	4
Schedule N – Liquidation, Termination, Dissolution or Significant Disposition of Assets	4.26%	17
Schedule O – Supplemental Information	1.25%	5
Schedule R – Related Organization and Unrelated Partnerships	5.51%	22
Total		**399**

Q31 On a scale from 1 to 5, does the Form 990 encourage responsible board governance and executive behavior? (5 being strongly encourages)

Answered: 399 Skipped: 1,470



	1	2	3	4	5	Total	Weighted Average
(no label)	4.51% 18	16.29% 65	38.35% 153	30.58% 122	10.28% 41	399	3.26

Q32 Are there any Parts/Schedules that you

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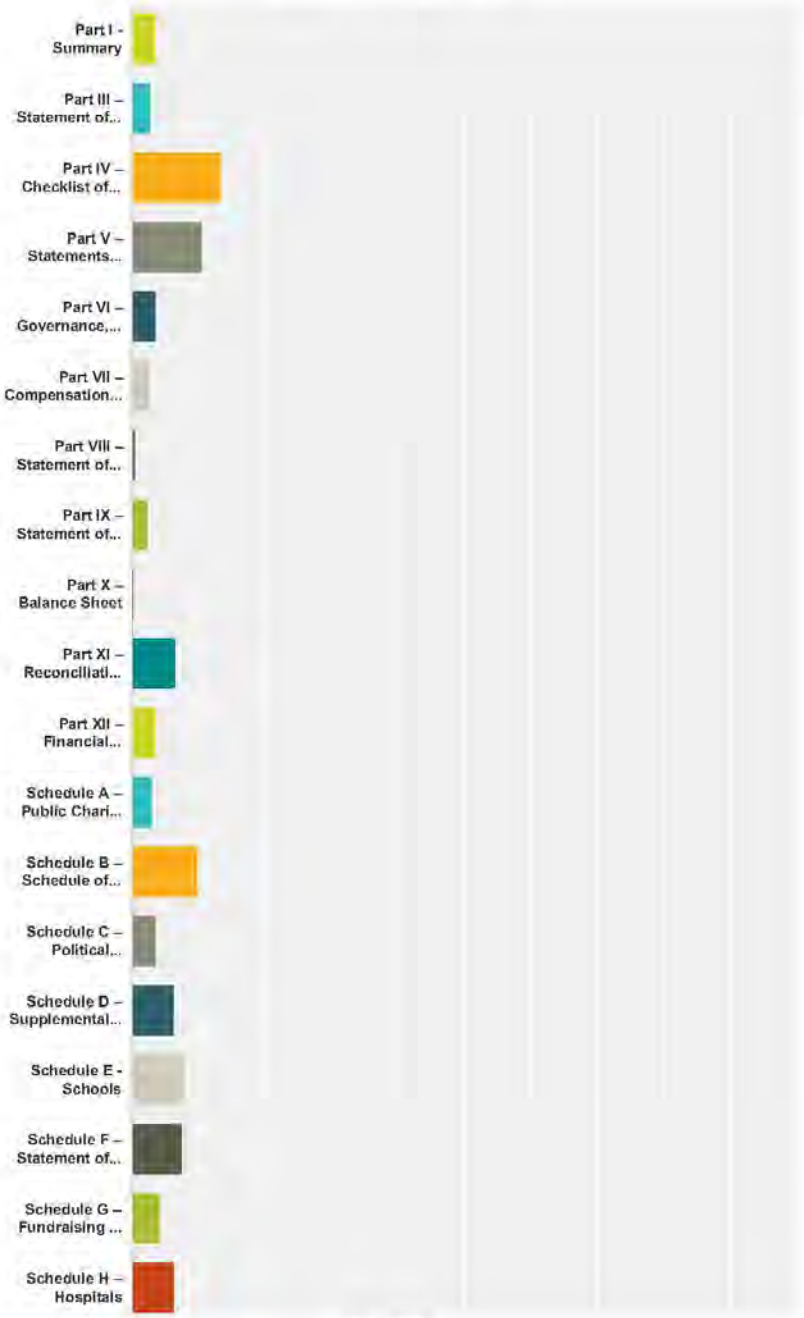
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

would like to see deleted from the Form 990? Select up to three.

Answered: 399 Skipped: 1,470



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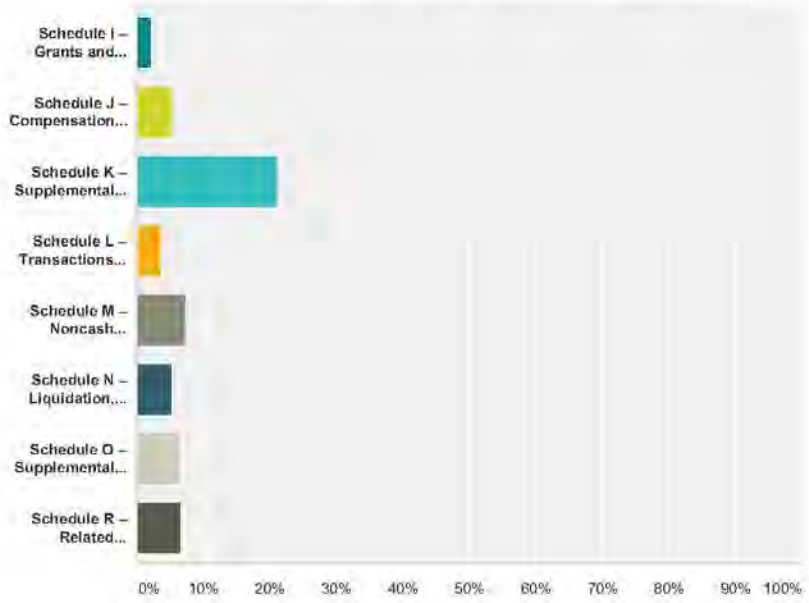
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
Part I - Summary	3.51%	14
Part III – Statement of Program Service Accomplishments	2.76%	11
Part IV – Checklist of Required Schedules	13.28%	53
Part V – Statements Regarding Other IRS Filings and Tax Compliance	10.53%	42
Part VI – Governance, Management and Disclosure	3.51%	14
Part VII – Compensation of Officers, Directors, Key Employees, Highest Compensated Employees, and Independent Contractors	2.51%	10
Part VIII – Statement of Revenue	0.50%	2
Part IX – Statement of Functional Expenses	2.26%	9
Part X – Balance Sheet	0.25%	1
Part XI – Reconciliation of Net Assets	6.52%	26
Part XII – Financial Statements and Reporting	3.51%	14
Schedule A – Public Charity Status and Public Support	3.01%	12
Schedule B – Schedule of Contributors	9.77%	39
Schedule C – Political Campaign and Lobbying Activities	3.51%	14
Schedule D – Supplemental Financial Statements	6.27%	25
Schedule E - Schools	7.77%	31

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Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

Schedule F – Statement of Activities Outside the United States	7.52%	30
Schedule G – Fundraising and Gaming Activities	4.26%	17
Schedule H – Hospitals	6.27%	25
Schedule I – Grants and Other Assistance to Organizations, Governments and Individuals in the U.S.	2.01%	8
Schedule J – Compensation Information	5.26%	21
Schedule K – Supplemental Information on Tax-Exempt Bonds	21.05%	84
Schedule L – Transactions with Interested Persons	3.51%	14
Schedule M – Noncash Contributions	7.27%	29
Schedule N – Liquidation, Termination, Dissolution or Significant Disposition of Assets	5.26%	21
Schedule O – Supplemental Information	6.27%	25
Schedule R – Related Organization and Unrelated Partnerships	6.52%	26
Total Respondents: 399		

Q33 Is there anything not included on the Form 990 that you wish were included?

Answered: 131 Skipped: 1,738

Q34 Would you like to provide any other comments regarding the Form 990?

Answered: 132 Skipped: 1,737

Q35 Approximately how many Form 990s do you look at/prepare each year?

Answered: 399 Skipped: 1,470

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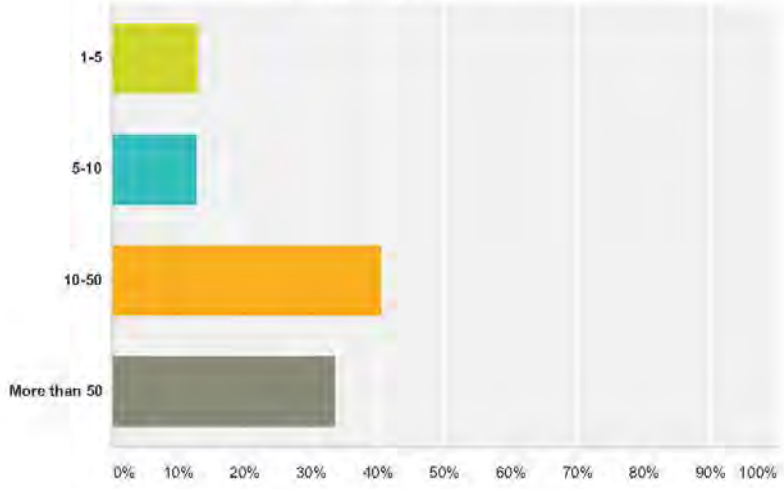
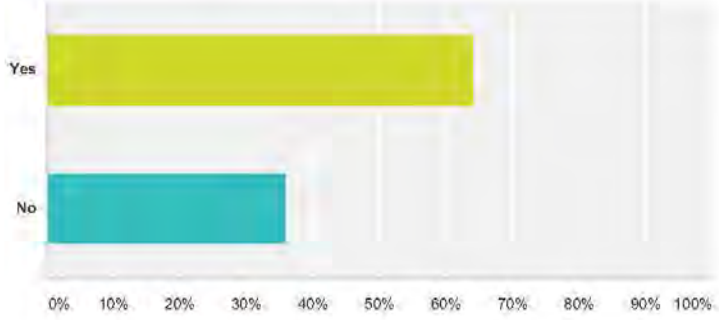
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.



Answer Choices	Responses	
1-5	13.03%	52
5-10	12.78%	51
10-50	40.60%	162
More than 50	33.58%	134
Total		399

Q36 Would you like to receive a link to a copy of the ACT final report once it is completed?

Answered: 1,236 Skipped: 633



Answer Choices	Responses	
Yes	64.00%	791

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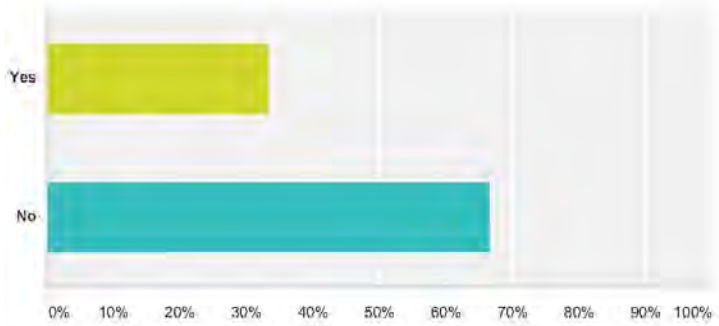
Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

No	36.00%	445
Total		1,236

Q37 Would you be willing to talk with members of the ACT about your responses to this questionnaire?

Answered: 1,236 Skipped: 633



Answer Choices	Responses	
Yes	33.33%	412
No	66.67%	824
Total		1,236

Q38 If you answered 'Yes' to one or both of the questions above, please provide your email address below. Your responses will not be attributed to you or your organization unless explicit permission is obtained.

Answered: 693 Skipped: 1,176

Answer Choices	Responses	
Name:	0.00%	0
Company:	0.00%	0
Address:	0.00%	0
Address 2:	0.00%	0
City/Town:	0.00%	0
State:	0.00%	0

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Form 990 Questionnaire - Please respond to these questions in light of your experience with the most recently filed Form 990.

ZIP:	0.00%	0
Country:	0.00%	0
Email Address:	100.00%	993
Phone Number:	0.00%	0

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Federal, State and Local Governments: FSLG Education and Outreach - Review and Recommendations

Dean Conder

Vandee DeVore

David Augustine

June 17, 2015

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I. EXECUTIVE SUMMARY

The IRS Tax Exempt and Government Entities Division and Federal, State, and Local Government (FSLG) component serves federal, state and local governments by ensuring proper compliance with the federal Internal Revenue Code (IRC). The U.S. Census Bureau reports that there were 90,106 state and local government employers as of June 30, 2012, with over 19 million full and part-time employees with payrolls in excess of $65.5 billion annually. FSLG currently employs 51 revenue agents assigned to state and local governments.

The difficulty of administering payroll tax with state and local governments is compounded by the existence of Section 218 of the Social Security Act (42 U.S.C. 418). While this law is under the proper jurisdiction of the Social Security Administration, its application to state and local governments is the basis of determining the correct tax liability. To complicate matters, in addition to the IRC, FSLG agents (and, indeed, the taxpayer) must also understand the exceedingly complex and difficult area of state and local government employment tax.

The ACT FSLG Subgroup reviewed FSLG's education and outreach efforts and materials. To assess the effectiveness of those efforts, a survey of FSLG customers was conducted via an on-line survey (survey and responses available here: https://www.surveymonkey.com/results/SM-HF77HVH7/) that was distributed through various professional organizations. The results of which (along with focus group data) form some of the recommendations in this report.

As this area of tax is unique and requires specialized knowledge, the ACT FSLG Subgroup also reviewed the training provided to FSLG agents. ACT members reviewed the training materials and conducted a focus group on such training. The results of the focus group form some of the recommendations in this report.

The ACT FSLG Subgroup makes the following recommendations (numbered for ease of reference, not necessarily importance):

- Recommendation #1: Encourage more face- to- face interactions and training between FSLG agents and state and local governmental officials.
- Recommendation #2: Seek ways to improve awareness of FSLG (and IRS) compliance tools.
- Recommendation #3: Provide at least a 30-day notice of virtual training events.

- Recommendation #4: Create a centralized repository of pre-approved information and training to avoid duplication and delays, and to take advantage of best practices.
- Recommendation #5: Consider suggested edits to IRS Form 14581, FSLG Self Assessment.
- Recommendation #6: Improve accuracy and comprehensiveness of Section 218 training materials.
- Recommendation #7: Make agent skills assessment and improvement a core function.

II. INTRODUCTION

The IRS Tax Exempt and Government Entities Division and Federal, State, and Local Government (FSLG) component serves federal, state and local governments by ensuring proper compliance with the federal Internal Revenue Code (IRC). The U.S. Census Bureau reports that there were 90,106 state and local government employers as of June 30, 2012, with over 19 million full and part-time employees with payrolls in excess of $65.5 billion annually. FSLG currently employs 51 revenue agents assigned to state and local governments.

The difficulty of administering payroll tax with state and local governments is compounded by the existence of Section 218 of the Social Security Act (42 U.S.C. 418). While this law is under the proper jurisdiction of the Social Security Administration, its application to state and local governments is the basis of determining the correct tax liability. To complicate matters, in addition to the IRC, FSLG agents (and, indeed, the taxpayer) must also understand the exceedingly complex and difficult area of state and local government employment tax.

The use of education and outreach is paramount to the successful administration of the IRC for this taxpayer subgroup. While these FSLG agents focus 90 percent of their efforts on compliance and 10 percent on education and outreach, the sheer number of customers per agent requires effective outreach schemes and materials. With limited resources, FSLG must determine how best to use these educational resources, i.e., answer all customer questions directly, or point customers to available IRS and other resources (webinar, phone forums, publications, etc.). In 2010, FSLG conducted 243 “live events,” in which face-to-face education was presented to their customers. In contrast, in 2014 FSLG conducted only 90 “live events,” in which face-to-face education was presented showing a shift from presenting fewer in-person outreach events, but with a focus to larger audiences.

The ACT FSLG Subgroup reviewed FSLG’s education and outreach efforts and materials. To assess the effectiveness of those efforts, a survey of FSLG customers was conducted via an online survey that was distributed through various professional organizations. The results of which (along with other research and data) is the basis of this report.

The ACT FSLG Subgroup examined the history of state and local government employment tax and the various changes that have resulted in a complex, and often

times confusing, set of laws and regulations.[1] It also examined the effectiveness of FSLG outreach and agent education on the subject of Section 218 of the Social Security Act. The results of this research are summarized and recommendations are formulated to aid FSLG and its agents to better assist their state and local government customers. It must also be stressed that FSLG customers are unique among taxpayers, and understanding who these customers are is the overriding point to successful outreach. It must, therefore, be recognized that FSLG customers have great diversity in expertise and experience, ranging from the very sophisticated large governments to the novice, part-time bookkeeper at small local governments. All FSLG customers do, however, have a common characteristic in that being units of government, they understand the need for taxation and generally lack a personal or profit motive to evade compliance.

[1] The State of Colorado documented a minimum of 500 FICA compliance scenarios affecting state and local government employers where not only does the compliance scenario vary from employer to employer, but also from employee to employee.

III. HISTORY

Social security taxes were first collected in 1937. The funding mechanism for the social security program was officially established in the Internal Revenue Code (IRC) as the Federal Insurance Contributions Act (FICA). Under the original Social Security Act of 1935, state and local government employees were excluded from social security coverage because of unresolved legal questions regarding the federal government's authority to impose taxes on state and local governments and their employees.

Beginning in 1951, states were allowed to enter into voluntary agreements with the federal government to provide social security coverage to public employees. These arrangements are called "Section 218 Agreements" because they are authorized by Section 218 of the Social Security Act. Originally, government entities filed with the Social Security Administration (SSA), but since 1987, the IRS has been responsible for collecting these taxes from governmental employers. All 50 states, Puerto Rico, the Virgin Islands, and approximately 60 interstate instrumentalities have Section 218 Agreements with SSA, providing varying degrees of coverage for employees in each state.[2] Thus, this adds to the complexities since there is no possibility for a standardized nationwide legal structure because coverage and the associated tax for Social Security and Medicare vary from state to state and entity to entity (and even from employee to employee).

A foundational premise in this area (unlike other areas of the IRS) is that state and local government employers *want* to comply. These customers understand the need for taxation and generally lack a personal or profit motive to evade compliance. Thus, it must be assumed that, in the majority of cases, noncompliance is a result of misunderstanding or lack of information.

Previous ACT Committee reports recommended various tools and processes to aid FSLG customers in understanding this complex area. In 2010, the FSLG ACT Subgroup designed and recommended a self-assessment tool for state and local government employers to use to assess their level of compliance. This tool ultimately became IRS Form 14581, FSLG Self-Assessment. The current report also examines IRS Form 14581 to measure use and to make recommendations for improvement.

The current project and report looks at two specific areas that effect the proper compliance with state and local government FICA laws. First, FSLG agents whose charge is to enforce the IRC must have an adequate understanding of Section 218 of

[2] See IRS Publication 963, Chapter 1 for historical overview of state and local government FICA coverage.

the Social Security Act (codified at 42 U.S.C. 418) along with related regulations and Social Security Administration policy. This report looks at the training provided to FSLG agents on this topic and makes recommendations for improvement. Next, as noted in the Introduction of the report, FSLG must rely upon education and outreach to customers to achieve maximum compliance (especially given the number of FSLG agents compared with the total number of customers they must serve).

IV. DUE DILIGENCE

FSLG Education and Outreach

The ACT FSLG subgroup members met with Mr. Paul Marmolejo, FSLG Director, and some of his staff during our meetings in June, August and October, 2014. Initial questions focused on current FSLG products (outreach tools and publications) and procedures. It was determined that a survey of FSLG customers would be beneficial to ascertain the amount of use and the effectiveness of the various FSLG outreach tools and efforts. Similarly, it would be beneficial to speak with FSLG agents to garner their insight on customer outreach and education.

External Customer Survey - The ACT FSLG subgroup formulated a survey to seek input from FSLG customers on outreach tools and events. (The survey and results can be viewed here: https://www.surveymonkey.com/results/SM-HF77HVH7/). It was distributed through various professional organizations and other outlets. (See Appendix A for distribution list) The survey was open for responses from November 6, 2014 to February 27, 2015. This survey data was analyzed to form some of the recommendations in the conclusion section of this report.

Customer Survey Results – A total of 385 responses to the survey were received. The vast majority of responses came from the government employers themselves (94 percent) with a wide range of responses from all government types and positions, e.g., budget officer, payroll clerk, etc. This survey was also very beneficial by allowing participants the opportunity to provide comments or additional information for each question. Of note, many respondents found the survey important enough to spend the extra time and effort to provide this narrative feedback. Survey Question 14 asked respondents for suggestions or recommendations for how FSLG can be more useful or helpful to their organization. Survey Question 7 asks respondents to identify professional organizations that are helpful in performing one's job. FSLG is encouraged to use these organizations in marketing their outreach tools.

Survey participants were first asked what mode of communication was most preferred: A slight majority of 36 percent preferred face-to-face presentations, followed by webinars at 31 percent and blast e-mails at 17 percent. Survey Question 5 asked for other suggested types of communication tools and the responses should be considered by FSLG. Next the survey asked whether the person or organization had any interactions with FSLG: more than a third said they had (35 percent) while 65 percent said "no."

The next section of survey focused on particular tools and events used by FSLG. In response to the question of attending a FSLG webinar or webcast, 34 percent said they had attended. A concern, however, was identified in that 33 percent did not know about FSLG webinars or webcasts. In rating the FSLG webinars, 13 percent of survey participants felt the program content was “Excellent” and 35 percent said the program content was “Good.” In regard to FSLG phone forums, 17 percent of survey participants had joined a phone forum, but again, a large percentage (43 percent) said they did not know about the forums. Of those attending a phone forum, less than 7 percent identified the program content as “Excellent” and 17 percent as “Good.”

The next section of the survey asked about IRS/FSLG forms, publications, webpages, and other tools. (See Question 12 of the survey for a list of publications, forms and webpages). Of note, IRS Publication 15[1] is a tool used by 72 percent of survey respondents, while 62 percent of the respondents use the IRS/FSLG website tool. Once again a large percentage of the respondents stated that they were not aware of the tools. Question 13 of the survey asked respondents to rate each publication and other tools. For those who use the publication, overall the publications and other outreach tools offered by FSLG were viewed as “Very Helpful” or “Helpful,” with only a few (less than 2 percent) rating the materials as “Not Very Helpful.” The *Employers Tax Guide, IRS Publication 15,* had the highest rating with 76 percent saying the publication was “Very Helpful” or “Helpful.” Retirement Plans for Government Employers webpage had the lowest rating with only 16 percent saying it was “Very Helpful” or “Helpful.”

The survey data, as a whole, reveals two overarching themes: customers exposed to FSLG outreach products generally find them useful and helpful, but the lack of awareness of these tools by FSLG customers has greatly hindered their effectiveness in providing the critical education and outreach.

FSLG Outreach Focus Group – The ACT FSLG subgroup conducted a teleconference focus group of ten FSLG agents in regard to outreach tools and efforts on October 27, 2014. Anonymity was offered to ensure frank and honest answers. A total of 17 questions were asked allowing time for each participant to provide his/her insight (See Appendix B for Focus Group on Outreach Questionnaire). Individual responses were recorded by the ACT members and distilled into a group response to serve as data for this report. Those findings are:

- Face–to-face is most effective per IRS staff
- Phone forums come across as scripted and impersonal
- Web feedback needs to be easier for both the customer and the presenter

[1] While IRS Publication 15 is not exclusive to governmental entities with different withholding requirements, it is widely used by FSLG customers.

- Approvals can be cumbersome and time consuming to receive, especially for web-based presentations, and limit interactivity and spontaneity of presentation
- Create a centralized repository of pre-approved information and training to avoid duplication and delays, and to take advantage of best practices
- Begin recording regional training events and posting on website
- Insert a review process into the approval track to ensure the information being presented is accurate
- Extend announcement of webinar events for better participation.
- Better overall marketing of all publications available on the web and subscription services
- Realize that state specific issues are prevalent and need specialized attention
- Customer satisfaction survey does not capture learning effectiveness

FSLG Agent Section 218 Training

The ACT FSLG subgroup members met with Mr. Paul Marmolejo, FSLG Director, and some of his staff during our meetings in August and October, 2014. Initial questions focused on current FSLG practices and procedures regarding "Phase Training"[2] and the inclusion of Section 218. ACT members reviewed the written training materials and determined that it would be beneficial to speak with FSLG agents to garner their insight on the training they receive in regard to Section 218.

FSLG Section 218 Training Focus Group – The ACT FSLG subgroup conducted a teleconference focus group of ten FSLG Agents soliciting feedback on Section 218 training provided to new and existing FSLG agents. Again anonymity was offered to ensure frank and honest answers. A total of ten questions were asked allowing time for each participant to provide their response. (See Appendix C for Focus Group Section 218 Training Questionnaire) Individual responses were recorded by the ACT members and distilled into a group response to serve as data for this report. Those findings are:

- 218 training is not consistent or periodic
- Space out 218 training so information can be better absorbed
- Use up to date materials and documents in training including SSA's State and Local Handbook
- Group meetings can be effective in refining knowledge
- Use practical experience and real documents in Phase training
- Utilize NCSSSA as a partner in training for 218 issues

[2] "Phase Training" is progressive training new FSLG agents receive upon joining FSLG. It includes various aspects of IRS policies and procedures, as well as topic specific instruction.

- Create specific OJI (On the Job Instructor) training specific to 218 issues

The ACT FSLG subgroup members with knowledge and experience in Section 218 matters reviewed and discussed the current training materials used by FSLG in "Phase Training" and suggest that an EXTENSIVE review be made with aid of National Association of State Social Security Administrators (NCSSSA)[3] .

IRS Form 14581 – FSLG Compliance Self-Assessment

IRS Form 14581 was conceived and developed in 2010 by a prior ACT FSLG Subgroup as a way for state and local government employers to assess their level of compliance with the complex set of laws pertaining to them. Current ACT FSLG Subgroup members reviewed the form and asked members of NCSSSA to also review it to make suggested edits and changes. The combined suggested edits are contained in Appendix D (presented in a Word document) and are recommended for consideration the next time the form is revised.

[3] The National Conference of State Social Security Administrators (NCSSSA) is only professional organization of state officials whose duties include the administration of Section 218 Agreements for their states.

V. CONCLUSION

Lessons Learned

FSLG must maximize the use and effectiveness of education and outreach. FSLG customers are unique among taxpayers and understanding who these customers are is paramount to successful outreach. The survey data, as a whole, reveals two overarching themes: customers exposed to FSLG outreach products generally find them useful and helpful, but the lack of awareness of these tools by FSLG customers has greatly hindered their effectiveness in providing the critical education and outreach.

The difficultly faced by FSLG agents tasked with administering payroll tax with state and local governments is compounded by Section 218 of the Social Security Act. Proper enforcement starts with understanding and education on this complex subject. It is vital to determining the correct tax liability of employers. FSLG can improve its "Phase Training" to better educate its agents on Section 218, especially as it applies to each individual state and local employer.

Recommendations
(Numbered for ease of reference, not necessarily for importance)

- Recommendation #1: Encourage more face- to -face interactions and training between FSLG agents and state and local governmental officials.

The FSLG group has an extremely unique area of enforcement responsibility. In this area of the IRS, the taxpayers are governmental entities who also have the responsibility of proper tax withholding, driven by open accountability to their constituents. It is a political subdivision's desire to withhold employee taxes correctly; however, understanding the complexities of correctness becomes the challenge. That, coupled with their own state tax regulations, makes this the one of the most complex enforcement areas within the IRS. Recent budget cuts and other factors have severely limited the outreach activities of FSLG. These directives are counterproductive to a unique unit within the IRS whose primary educational tool for compliance and enforcement is based upon outreach activities. Based upon survey responses, more than a third (36 percent) of respondents noted that face-to-face outreach is the most successful means in achieving an understanding of the special details related to State and Local government issues. Our interviews with the FSLG Agents confirmed that face-to-face outreach is most effective for improving compliance. We recommend a reversal to these restrictions and directives, and further recommend that additional resources be allocated to increase outreach activities of FSLG Agents.

- Recommendation #2: Seek ways to improve awareness of FSLG (and IRS) compliance tools.

As discussed above, one glaring result of the survey conducted by the ACT FSLG Subgroup was that a high percentage of respondents were unaware of the various outreach tools and publications. We recommend that efforts be made to engage those organizations identified in Question 7 of the survey to advertise these tools. Each organization has numerous members, thus multiplying the number of taxpayers reached with each marketing effort. The tools and publications offered by FSLG are very good and those taxpayers using those tools find them useful – but, only when they know of them and can easily access them.

- Recommendation #3: Provide at least a 30-day notice of virtual training events.

The focus group identified that attendance for virtual training events suffers when there is too little notice and taxpayers have difficulty placing such event on a busy calendar. Practical experience of the ACT members supports this conclusion. Often times we get notice of the event with less than a week between the notice and the event. Also to aid in providing more advanced notice it is recommended that TEGE work with the Servicewide Video Editorial Board (SVEB) to gain approval of events without a presentation date. Once the production is approved a reasonable future date can be established and the event marketed to FSLG customers well before the event is ultimately scheduled.

- Recommendation #4: Create a centralized repository of pre-approved information and training to avoid duplication and delays, and to take advantage of best practices.

In our interviews with agents, it came across that there was no systematic way that agents knew about each other's presentations to various groups. Many of these agents speak on the same core topics to groups. In addition, the approval process for each presentation can be daunting, especially the potentially long wait times for approvals of web-based and in-person presentations (up to two to three months). We recommend that approved presentations be available to all agents for use in the field, and agents be given latitude to assemble presentations from pre-approved materials. We think this will result in less time spent on internal administrative matters for field agents and more time spent communicating with state and local government employees, as well as the use of the most accurate and up-to-date training materials.

- Recommendation #5: Consider suggested edits to IRS Form 14581.

Suggested edits are contained in Appendix D (presented in a Word document) and are recommended for consideration the next time the form is revised.

- Recommendation #6: Improve accuracy and comprehensiveness of Section 218 training materials.

A comprehensive review of Lesson 6 for Phase I Training, and Lesson 1 for Phase 2 Training was completed by the Subgroup members specializing in Section 218 coverage issues. We find both segments to be inconsistent in fact and confusing to a new trainee. This is also reflected in the comments made by tenured FSLG Agents when asked to recall their original Phase Training experiences. It is a fundamental concept to learn that public entities "opt-in" to Section 218 coverage since it is voluntary. Any reference to "opt-out" should be removed from the training materials. Many statements throughout the Phase Training materials do not differentiate between a FICA equivalent retirement system and a Non-FICA equivalent retirement system, only referring to all as "public retirement systems." In training for Section 218 coverage, it is imperative to understand the differences in coverage caused by participation in either FICA or non-FICA equivalent plans. The most consistent error throughout both Phases is the absence of retirement system ineligibles coverage. While provisions in IRS Code related to Mandatory Social Security excludes Rehired Annuitants from Social Security contributions, a Rehired Annuitant could be covered as a retirement system ineligible position under a Section 218 Agreement.[4] The absence of this explanation creates confusion and potential erroneous assessments. We recommend both sets of Phase Training materials be reviewed and updated for accuracy. Involving NCSSSA as a partner in this process, along with including State Administrators in the Phase Training events could also enlighten new agents in this distinctive area of enforcement.

- Recommendation #7: Make agent skills assessment and improvement a core function.

In a complex and technical area of tax law and regulations, agents possess various levels of knowledge of different aspects of the rules that apply to state and local government entities. We encourage the IRS to make the imparting of knowledge to agents more systematic, and spread throughout one's career—not only at the beginning. In addition, we encourage the IRS to assess agents based on knowledge and facility with these complex areas, which would also help identify areas for improved training.

[4] See IRS Pub. 963 for explanation of Rehired Annuitants and Section 218 coverage of retirement system ineligible employees.

Appendix A - 2015 FSLG Subgroup Report

Organization	
ABA	American Bar Association
AGA	Association of Government Accountants
AICPA	American Institute of Certified Public Accountants
FASAB	Federal Accounting Standards Advisory Board
GFOA	Government Finance Officers Association
IIA	Institute of Internal Auditors
KPMG Govt Institute	KPMG Government Institute
NACo	National Association of Counties
NASACT	National Association of State Auditors, Controllers, & Treasurers
NASRA	National Association of State Retirement Administrators
NCSSSA	National Conference of State Social Security Administrators
NLC	National League of Cities
GASB	Governmental Accounting Standards Board
NCTR	National Council of Teacher Retirement
NCPERS	National Conference on Public Employee Retirement Systems
Deloit	Deloit, Inc. (Courtney Flaherty)
PWC	Price Waterhouse Coopers (Matthew Liberty)
Ernst & Young	Ernst & Young (Rollie Quinn)

Appendix B – 2015 FSLG Subgroup Report

IRS (FSLG) Focus Group on Outreach Tools and Services

Purpose of Focus Group:
The IRS Advisory Committee on Tax Exempt and Government Entities (ACT) Federal, State and Local Governments (FSLG) Group is soliciting feedback on the effectiveness of outreach and marketing efforts to state and local government entities in order to offer suggested improvements and efficiencies.

Members of Focus Group:
Select FSLG Agents, Group Managers, and FSLG Staff

Interview Questions

1. What is the average time you spend in outreach activities, compared to other activities?
2. What type of outreach activity do you feel is most effective in educating public entities?
3. Do you solicit outreach engagements, or are most of your activities initiated by outside sources?
4. How do you feel the Entities react to outreach activities?
5. What is your opinion of the Effectiveness of outreach tools, e.g., Forms and Publications?
6. In your experience, what tool is used most by government entities?
7. Are tools adequate to meet the users' needs?
8. Do the tools use simple enough language to explain the complex?
9. When conducting a "compliance check," do you ask the entity if they use any of the FSLG tools, publications, webinars, etc.?
10. Have you specifically suggested use of the FSLG Self-Assessment Tool (Form 14581) to public entities?
11. In your opinion, what improvements can be made to FSLG outreach efforts?
12. In your opinion, what improvements can be made to FSLG outreach tools?
13. Do you notice an upswing in questions immediately after the FSLG Newsletter is issued?
14. Is there any type of upward reporting from questions received as feedback from an FSLG Newsletter or other outreach tool or activity?
15. From your experience in the field, do you believe majority of public entities have access to the internet and email?
16. Do you see any trends in subject areas of compliance weakness in the public entities you audit and check?
17. Other Suggestions

Appendix C – 2015 FSLG Subgroup Report

IRS (FSLG) Focus Group on Section 218 Training

Purpose of Focus Group:
The IRS Advisory Committee on Tax Exempt and Government Entities (ACT) Federal, State and Local Governments (FSLG) Group is soliciting feedback on Section 218 Training provided to new and existing FSLG agents in order to offer suggested improvements and efficiencies.

Members of Focus Group:
Select FSLG Agents, Group Managers, and FSLG Staff

Interview Questions

1. How effective was your 218 Training?
2. Is the written material easy to understand?
3. Was the presentation of material easy to understand?
4. How can 218 Training be improved?
5. Is Phase training helpful? Do you feel it necessary to have a better understanding of basics before moving on to issue specific topics?
6. Now that you've been in the field and had some years of experience, do you feel the 218 portion of your Phase Training prepared you for these topics encountered as an Agent? In what ways was the Training good (or lacking)?
7. The State Administrator maintains coverage Modifications and other documentation for each entity. Explain how the Phase Training specifically prepared you to develop questions and tools to evaluate the Mods and other related documents.
8. The differences between divided and majority vote referenda can affect proper coverage you uncover during an audit. Explain your experiences in learning this concept during the Phase Training?
9. Given the complexities of 218, what recommendations do you have to improve the training materials?

What kind of ongoing training have you had regarding 218?

Form 14581
(February 2014)

Department of the Treasury - Internal Revenue Service

~~FSLG~~ State & Local Government Compliance Self-Assessment

Introduction

This ~~FSLG~~ State and Local Government Compliance Self-Assessment Tool is a resource designed by the Advisory Committee on Tax E Government Entities (ACT) and the IRS office of Federal, State and Local Governments (FSLG) for voluntary and confidential use by stat government entities to conduct a self-assessment of their level of compliance with Federal tax requirements.

Public employers have unique legal requirements for compliance with federal tax and social security laws. These employers need to be a rules that apply to them and their workers (both employees and independent contractors), especially those related to federal income, s security, and Medicare taxes and public retirement system obligations.

The self-assessment tool is designed to help public employers identify areas that indicate potential compliance issues. It is intended to completed by the persons responsible for withholding and paying employment taxes in the organization.

At the beginning of each section, there is a brief description of the basic legal requirements that apply to public employers for that catego cases, a brief description of the law is provided with links to IRS publications or other material that will provide more complete informat topic.

Note: This self-assessment tool is intended as a general guide to the most common tax issues that public employers may encounter, a those entities to additional information as necessary. It is not intended to provide legal advice. It does not cover every question that ma encountered. The tool is provided for general information only and should not be relied upon as legal advice or a determination by the respect to a particular tax situation. The sources cited should be reviewed for complete information.

Common Errors

FSLG conducts two types of activities to measure compliance with tax laws; compliance checks and examinations. An examination is t systematic inspection of the books and records of a taxpayer for the purpose of making a determination of the correct tax liability. A co check is a contact with the taxpayer that involves a review of filed information and tax returns of the entity. It is less burdensome and ca be accomplished in one or two contacts with the taxpayer. A compliance check serves as an opportunity to educate the taxpayer and e compliance with regard to employment tax law and filing requirements.

From past compliance checks and examinations of public employers conducted by FSLG, a number of common errors have been iden Some of these are listed below.

- Totals shown on Forms 941 or Form 944 do not reconcile with totals on Forms W-2 and W-3, or between these forms and the accou records.
- Forms W-9 and W-4 are not being used or are not being updated when necessary.
- Failure to backup withhold on payments to vendors when required.
- Failure to correctly complete or file Forms 1099.
- Failure to apply accountable plan rules to reimbursements and allowances.
- Incorrect or missing employment tax deposits.
- Failure to follow electronic filing requirements.
- Treatment of certain groups of workers as independent contractors, rather than as employees.
- Failure to pay and withhold Medicare-only tax on rehired annuitants.
- Failure to include taxable noncash benefits in employee wages.
- Failure to correctly apply withholding rules to election workers and public officials.

For Assistance While Completing the Form:

The following federal tax information is accessible from the FSLG website at www.irs.gov/govt/fslg.

- FSLG Toolkit
- Publication 15, Employers Tax Guide
- Publication 15-A, Employer's Supplemental Tax Guide
- Publication 15-B, Employer's Guide to Fringe Benefits
- Publication 963, Federal-State Reference Guide
- Publication 1779, Independent Contractor or Employee
- Publication 5138, Quick Reference Guide for Public Employers
- Publication 5137, Fringe Benefit Guide
- Retirement Plans for Government Employer (IRS FSLG)
- Governmental Plans Information (IRS Employee Plans)

General social security information is available at the Social Security Administration website and more specific information pertinent to government employers and employees is available at: http://www.ssa.gov/slge/.

The National Conference of State Social Security Administrators (NCSSSA) website includes contact information for the state Social Security Administrators, who are responsible for maintaining and administering the states' Section 218 Agreements and Modifications with the Social Security Administration.

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Comment [A1]: General comment on the form. This Word version has some typos that probably came across when the on-line version of the form was converted to Word to enable editing and comments. A complete spell check of the original on-line form should be done to make sure there aren't any such errors in the public document.

Comment [A2]: The form was initially designed and developed by members of the ACT Committee, with FSLG's input. Many of the original aspects of the form, such as including links to key reference materials and brief explanations of items were not supported by the IRS/FSLG until they and the IRS Commissioner saw the results of the ACT survey of public employers which clearly showed that information was helpful to FSLG's customers.

Comment [V3]: Specify what type of taxes. In governments, we don't have the same "employment taxes" as business entities.

Comment [V4]: This needs flip flopped to match with the sentences that follow it. Examinations first, then compliance checks.

Comment [A5]: Recommend updating, as necessary and appropriate.

Also recommend including the latest list of Section 218 Risk Areas.

Comment [A6]: Make sure all links are active and current.

Add link to Affordable Care Act information.

Comment [A7]: Replace comma (,) with a period (.).

For Assistance and Further Information After Completing the Form:
An FSLG Specialist can help you interpret the results of the self-assessment and ensure that you know what, if any, steps you need to take to be fully compliant with all applicable federal tax laws, rules and regulations. The names and contact information for FSLG staff are available at local FSLG Contact Information.

~~The FSLG Specialist may recommend that you~~ You should contact your State Social Security Administrator for clarifications and information about a Section 218 Agreement or Modification, how to obtain Medicare-only coverage for Medicare-exempt employees or other similar information. Each state has unique laws governing voluntary social security and Medicare coverage. Agreements for state and local governments can be obtained through ~~the NCSSSA~~ your State Social Security Administrator. ~~You may also contact SSA for additional information about coverage and benefits under social security and Medicare.~~

FSLG offers a process by which a government employer can voluntarily disclose an identified error and solicit resolution via a walk-in closing agreement. Employers interested in such a resolution may contact an FSLG Specialist or submit a detailed letter disclosing the specific nature of the tax error, the employees affected and their proposed resolution. The letter should be submitted to the following address:

Internal Revenue Service
T:GE:FSLG:CPM
1111 Constitution Avenue NW
Washington, DC 20224
ATTN: Closing Agreement Coordinator

Compliance Categories:
The self-assessment tool consists of the following seven categories.

1) Social Security (Section 218 Agreement and Mandatory Social Security)
2) Medicare
3) Retirement Plan Coverage
4) Worker Classification: Employee versus Independent Contractor
5) Fringe Benefits
6) International Issues
7) Affordable Care Act
~~6)~~ Other Tax Issues: Information Returns, Independent Contractor Vendors, Payments, Back-up Withholding, and Timely Filing of Returns

Comment [V8]: This should be deleted since the SSSA is supposed to be the liaison between the political subdivisions and the SSA.

Comment [A9]: Is this address still correct?

Comment [A10]: This needs to be the first category. If a worker is truly an "independent contractor" most of the intervening compliance categories (at least before "other Tax Issues, etc.") are not relevant.

Determining if someone is or is not an employee is THE threshold question to be answered for the remainder of the answers to be meaningful.

Comment [A11]: Add Affordable Care Act as a separate category prior to the "Other Tax Issues, etc." item.

Comment [A12]: Add information about the Social Security Benefits Offsets that was included in the original 2010 ACT recommendation for the Compliance Verification Checklist (see the attachment, pages 26-27).

The IRS indicated that compliance with SSA Form 1945 was outside of their statute and jurisdiction so they did not include it in the final form. That argument is specious, however, because this form is meant to be a compliance self-assessment tool for public employers and their legal and financial advisors and, therefore, it should be comprehensive. Public employers do not care which federal agency's laws apply to them; they just need to know everything with which they must comply in order to avoid negative consequences for them and their employees.

Besides, if the above argument for not including information about SSA Form 1945 were followed for everything else, Section 218 (which is under the Social Security Act, not the Internal Revenue Code) would be excluded from the self-assessment. If that were done, it would effectively eviscerate the entire form as a useful compliance tool.

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(February 2014)

Department of the Treasury - Internal Revenue Service

FSLG Compliance Self-Assessment

We suggest marking the boxes, as follows:

- OK - for items that either do not apply, or that apply but you believe that you are in compliance.
- Flag - the item applies but you are uncertain whether you are in compliance.

Ok	Flag	Item	Social Security
☐	☐	1.	Does the entity have a voluntary social security coverage agreement, often referred to as a 218 Agreement or Modification to the State's Section 218 Agreement? ☐ Yes ☐ No If not, SKIP to question 4 in this section. **Note:** If an entity is uncertain whether it is covered by a Section 218 Agreement or to obtain a copy of its Section 218 Agreement and any related modifications, contact the State Social Security Administrator at http://www.ncsssa.org/statessadminmenu.html.
☐	☐	2.	Have there been any Modifications to the 218 Agreement or the original Modification that provided Section 218 coverage for the entity or any positions? ☐ Yes ☐ No It may be ~~necessary~~necessary to contact the State Social Security Administrator to answer this question. If "yes", list all Modification numbers, dates and a description of changes to the Section 218 Agreement made by each Modification. If there have been no modifications, skip to Question 3. **List the Modifications:** **Note:** The State Social Security Administrators prepare Section 218 modifications to the states' agreements to include additional coverage groups, to correct errors in other modifications, to identify additional political subdivisions joining a covered retirement system or to obtain Medicare coverage for public employees whose employment relationship with a public employer has been continuous since March 31, 1986. To learn more, contact the State Social Security Administrator for the state.
☐	☐	3.	If the entity has a Section 218 Agreement, are services performed by any employees excluded in the modification or agreement from social security and Medicare coverage? ☐ Yes ☐ No **Note:** Federal law requires the exclusion of the following services from voluntary (Section 218) coverage under the Social Security Act (Section 218(c)(6)): • Services performed by individuals hired to be relieved from unemployment. • Services performed in a hospital, home or other institution by a patient or inmate thereof as an employee of a state or local government. • Services performed by an employee hired on a temporary basis in case of fire, storm, snow, earthquake, flood or similar emergency. • Services performed by a nonresident alien temporarily residing in the U.S., holding an F-1, J-1, M-1 or Q-1 visa, when the services are performed to carry out the purpose for which the alien was admitted to the U.S. • Covered transportation service as defined in SSA 210(k) **Note:** Federal law allows for the optional exclusion of the following services from voluntary (Section 218) coverage under the Social Security Act the state or entity may or may not have chosen to exclude these services. Each entity may have exclusions.: • Services in positions compensated solely by fees received directly from the public are subject to SECA (Self-Employment Contributions Act) taxes. • Services performed by a student enrolled and regularly attending classes at the school, college or university for which they are working. • Services performed by election officials or election workers paid less than the calendar year threshold amount mandated by law. • Services that would be excluded if performed for a private employer because they are not work defined as employment under Section 210(a) of the Social Security Act.

Comment [A13]: Seems question No. 1 and No. 2 are the same. Recommend delete No. 1 and keep No. 2.

Comment [V14]: Entity &/or Position(s)

Some positions may be covered by a statewide retirement system.

Comment [A15]: Elected officials is also an optional exclusion that needs to be in the list

Comment [A16]: Not an optional exclusion should be moved to mandatory exclusion list.

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Ok	Flag	Item	Social Security
			Note: The categories of employees excluded from the Section 218 Agreement may still be subject to social security and Medicare withholding under the Mandatory Social Security provisions if they do not participate in a retirement plan that replaces social security. **List the categories of workers excluded from coverage under the Section 218 Agreement:** See IRS Publication 963, Federal-State Reference Guide, for more specific information on exclusions from Section 218 coverage.
☐	☐	4.	Is the entity subject to mandatory social security coverage? [ ] Yes [ ] No **Note:** After July 1, 1991, full-time, part-time, temporary and seasonal employees who are not participating in a qualifying retirement system made available through their employer must be covered by social security, pursuant to §3121(b)(7)(F) of the Internal Revenue Code. The Code, however, exempts employees performing the following services from mandatory social security and Medicare taxes. • Services performed by individuals hired to be relieved from unemployment. Services performed in a hospital, home or other institution by a patient or inmate thereof as an employee of a state or local government. Services performed by an employee hired on a temporary basis in case of fire, storm, snow, earthquake, flood or similar emergency. Services performed by a nonresident alien temporarily residing in the U.S. holding an F-1, J-1, M-1 or Q-1 visa, when the services are performed to carry out the purpose for which the alien was admitted to the U.S. Services in positions compensated solely by fees received directly from the public are subject to SECA (Self-Employment Contributions Act), taxes, unless a Section 218 Agreement covers these services. Services performed by a student enrolled and regularly attending classes at the school, college or university for which they are working, unless a section 218 Agreement covers these services. Refer to http://www.socialsecurity.gov/slae/student coverage chart.htm for the student exclusions for each state. Services performed by election officials or election workers paid less than the calendar year threshold amount mandated by law unless a section 218 Agreement covers election workers. Services that would be excluded if performed for a private employer because they are not work defined as employment under Section 210(a) of the Social Security Act See IRS Publication 963, Federal-State Reference Guide, for more specific information on exclusions from mandatory social security coverage.

Notes

Comment [V17]: There may be some positions covered by mandatory even if they have a 218 agreement.

Ok	Flag	Item	Medicare
☐	☐	1.	Are any employees exempt from Medicare under the Continuing Employment Exception? "] Yes Q No **Note:** ~~Almost all state and local government employees are covered by Medicare.~~ All employees covered under a section 218 Agreement are covered and employees covered by mandatory social security tax are also covered, unless the employee meets the continuing employment exception, IRC §3121 (u). The continuing employment exception applies to an employee hired by a state or political subdivision employer before April 1, 1986, only if the employee is a member of a public retirement system within the meaning of IRC §3121 (b))7)(F) and meets ALL of the following requirements: • The employee was performing regular and substantial services for remuneration for the same state or political subdivision employer before April 1, 1986; • The employee was a bona fide employee of that employer on March 31,1986; • The employment relationship with that employer was not entered into for purposes of avoiding the Medicare tax; and • The employment relationship with that employer been continuous since March 31, 1986. The same services listed above under Social Security #4 that were excluded from mandatory social security tax are also excluded from the Medicare tax. Contact the State Social Security Administrator with any questions pertaining to the foregoing.
☐	☐	2.	Are there any employees from whom Medicare is not withheld, other than those who meet Q Yes '^] **No** the exceptions from employment listed above under "Social Security Tax", item number 3?
☐	☐	3.	Does the entity employ any rehired annuitants? Q Yes Q] No **Note:** A rehired annuitant is an individual who is rehired by his or her employer or another employer that participates in the same retirement system as the former employer. This includes a former participant in a state retirement system who has previously retired and who is either (1) receiving retirement benefits under the retirement system or (2) has reached normal retirement age under the retirement system.
☐	☐	A.	If "yes", (the employer does have rehired annuitants), is social security tax withheld and paid Q Yes f~J No on those employees?
☐	☐	B.	If "yes", is Medicare tax withheld and paid on those employees? Q Yes Q No **Note:** When an employee retires he or she has terminated employment for purposes of the continuing employment exception. Thus, if that former employee is rehired, he or she will be subject to Medicare tax, even if the employee was previously exempt on account of the continuing employment exception.

Notes

Comment [V18]: There's no guidance here. It depends on if the Rehired Annuitant position is a retirement system ineligible and if Ineligibles are covered by the 218 agreements.

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Ok	Flag	Item	Retirement Plan Coverage
☐	☐	1.	Does the entity have a public retirement system that qualifies as a replacement for social security coverage? ☐ Yes ☐ **No** **Note:** A governmental retirement plan must meet certain minimum benefit or contribution standards to qualify as a public retirement system, and thereby serve as a "replacement" plan exempting the participants from mandatory Social Security coverage. These standards are based solely on meeting a minimum benefit level provided (defined benefit plan) or a minimum amount contributed (defined contribution plan) to the participant. Any person working for a public employer after July 1, 1991, who is not covered in a public retirement plan that meets the requirements discussed above and, if applicable, the defined benefit system safe harbor rules of Revenue Procedure 91-40, must be covered by social security and Medicare under the mandatory coverage provisions of Section 210 of the Social Security Act. For more information about public retirement systems (social security replacement plans), see Chapter 6 of the Federal-State Reference Guide, Publication 963.
☐	☐	2.	Is the public retirement plan offered to all employees? ☐ Yes ( ) No If not, specify categories of employees that are NOT covered, *(specify all that apply)*. **Note:** Employees in these categories must be covered for social security either under mandatory coverage or under a Section 218 Agreement.
☐	☐	3.	Are the contributions to retirement plans subject to the applicable employment taxes? ☐ Yes [ ] No
☐	☐	A.	3121(b)(7)(F) Retirement Systems ☐ Yes ☐ No • Employee deferrals are exempt from federal income tax withholding but are subject to social security and Medicare taxes. • Employer contributions are exempt from federal income tax withholding, social security, and Medicare taxes. However, if the retirement system is not an "exempt governmental deferred compensation plan," employer contributions are subject to social security and Medicare withholding as of the later of when the services are performed, or when there is no substantial risk of forfeiture.
☐	☐	B.	401(a) and 403(b) Plans ☐ Yes ☐ **No** • Employee deferrals are exempt from federal income tax withholding but are subject to social security and Medicare taxes. • Employer contributions are exempt from federal income tax withholding, social security and Medicare taxes.
☐	☐	C.	457(b) Plans ☐ Yes ☐ **No** • Employee deferrals are exempt from federal income tax withholding but are subject to social security and Medicare taxes. • Employer contributions are exempt from federal income tax withholding but are subject to social security and Medicare taxes when no longer subject to substantial risk of forfeiture.

Notes

Comment [V19]: When this prints, this NOTE goes to the bottom of the square. Does that apply to #2, or to #3?? It is confusing the way it appears.

Comment [V20]: Don't use this term. Spell out specific withholdings.

Comment [A21]: Provide parenthetical explanation, if possible.

Comment [V22]: Not if they don't pay FICA on their wages.

Comment [V23]: Not if they don't pay FICA on their wages.

Comment [V24]: Not if they don't pay FICA on their wages.

Comment [A25]: Provide parenthetical explanation, if possible.

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Ok	Hag	Item	Worker Classification
☐	☐	1.	Are all workers properly classified as either employees or as independent contractors? ☐ Yes ☐ No Note: Under the common-law standards applied by the IRS, there are three categories of evidence (Behavioral Control, Financial Control and Relationship of the parties) that should be considered to determine whether the worker is an employee or independent contractor. See Publication 963, Chapter 4, for information about worker classification. Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, can be submitted to the IRS to obtain a determination on whether a particular worker is an independent contractor or employee of the entity.
☐	☐	2.	Does the entity have any of the following categories of workers? ☐ Yes ☐ No If yes, are they classified as employees?
☐	☐	A.	Elected officials ☐ Yes ☐ No Note: A public official has authority to exercise the power of the government and does so as an agent and employee of the government. For this reason, the Supreme Court has held that public officials are employees. A public official performs a governmental duty exercised pursuant to a public law. A public office is a position created by law, holding a delegation of a portion of the sovereign powers of government to be exercised for the benefit of the public. Elected officials are subject to a degree of control that typically makes them employees under the common law. Elected officials are responsible to the public, which has the power not to reelect them. Elected officials may also be subject to recall by the public or a superior official. In any event, elected officials are employees for income tax withholding purposes under Internal Revenue Code §3401 (c). Examples of public officials include, but are not limited to: governor, mayor, county commissioner, judge, justice of the peace, sheriff, constable, registrar of deeds, building and plumbing inspectors.
☐	☐	B.	Appointed officials ☐ Yes ☐ No Note: Generally, few appointed officials have sufficient independence such that they will not be considered common-law employees. See Publication 963.
☐	☐	C.	Fee-based positions ☐ Yes ☐ No Note: In general, if an individual performs services as an official of a governmental entity and the remuneration received is paid from governmental funds, the official is an employee and the wages are subject to Federal employment taxes.
☐	☐	3.	Do any employees also receive Form 1099-MISC, Miscellaneous Income, for services that are substantially similar to the services reported as wages on Form W-2, Wage and Tax Statement? ☐ Yes ☐ No If yes, the amounts reported on Forms 1099-MISC should be reported as Form W-2 wages subject to applicable employment taxes and not reported on Form 1099-MISC.

Notes

Comment [A26]: Suggest this be the first category, as it is the initial threshold.

Comment [V27]: Specify what type of taxes. In governments, we don't have the same "employment taxes" as business entities.

Comment [V28]: Specify what type of taxes. In governments, we don't have the same "employment taxes" as business entities.

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Ok	Flag	Item	Fringe Benefits - See Publication 15-B and Publication 5137, Fringe Benefit Guide
☐	D	1.	Does the entity have an "accountable plan" for reimbursement of business expenses incurred Q] Yes] No by employees? **Note:** In general, reimbursements or advances for expenses paid by the employer on behalf of the employee are taxable unless they are working condition fringe benefits and are ordinary and necessary employee business expenses that would otherwise qualify for a deduction by the employee, and the reimbursements or advances are made under an accountable plan. For payments to be considered to be made under an accountable plan, the employee must: a) Incur the expenses in the performance of work, b) Substantiate the expenses within a reasonable period of time, and c) Return any amounts in excess of expenses within a reasonable period of time. If accountable plan rules are met, no tax reporting is necessary. If the rules are not met, the reimbursements or advances are included in wages on Form W-2 and subject to the withholding and payment of employment taxes. The employee may deduct expenses as miscellaneous itemized deductions on his or her Form 1040.
☐	☐	2.	Does the entity include the taxable amount of the following fringe benefits as wages when applicable?] Yes \~I No
☐	☐	A.	Personal use of a government-owned vehicle 3! Yes IZI **Note:** Unless it is excludable as a qualified non-personal use vehicle, the personal use of a government-owned vehicle is a taxable fringe benefit. Personal use includes the value of commuting to and from work in a government-owned vehicle, even if the vehicle is taken home for the convenience of the employer. The fair market value of the fringe benefit must be included in wages and is subject to income and employment taxes. However, employee use of a qualified non-personal use vehicle qualifies as a working condition fringe. You can exclude the value of that use from employee income. A qualified non-personal use vehicle is any vehicle the employee is not likely to use more than minimally for personal purposes because of its design. The value of the use of the vehicle is determined using one of these methods. 1) General valuation rule: the fair market value of a fringe benefit is defined as the price a willing buyer would pay to a willing seller in an arm's-length transaction. 2) Alternate valuation rules: each of the following may be used under certain circumstances: a. Lease value rule- Determines the benefit by determining the annual lease value of the vehicle. b. Cents-per-mile rule- Personal use may be included in wages at a mileage rate (56.5 cents per mile for 2013) c. Commuting rule - An amount of $1.50 per one way commute is a taxable fringe benefit. **Note:** A detailed discussion of the valuation rules are included in Publication 15-B.
☐	☐	B.	Clothing provided by the employer I \~] Yes Q No **Note:** Clothing and uniforms provided by the employer are excluded from income if required by work and not suitable for non-business use.
☐	☐	C.	Group-Term Life Insurance f\~J Yes f\~J No **Note:** The annual cost of $50,000 of group-term life insurance may be excludable from social security, Medicare, and income tax for each employee. The table for determining the cost of additional insurance is included in Publication 15-B. The cost of group-term life insurance in excess of $50,000 is subject to social security and Medicare, but not to income tax withholding.
☐	☐	D.	Meals Yes No **Note:** Meals may be excludable from income in the following cases: • "De minimis" meals, for example, occasional group meals. • Meals for the convenience of the employer, provided on the business premises
☐	☐	E.	Lodging Yes No **Note:** Excludable if for employer's convenience as a condition of employment, if on the employer's business premises. Lodging costs may also be excludable if paid for or reimbursed as working condition fringe. See Publication 15-B for information on lodging as a fringe benefit.

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Comment [V29]: Define withholding taxes specifically.

Comment [A30]: Strike "Yes" "No" box as they are answered below.

Ok	Flag	Item	Fringe Benefits - See Publication 15-B and Publication 5137, Fringe Benefit Guide
☐	☐	F.	Educational Assistance O Yes Q No **Note:** May be excludable if qualifies: • under educational assistance program (up to $5,250 per year). • as a working condition fringe benefit. For more information, see Publication 970, Tax Benefits for Education.
☐	**D**	G.	Achievement awards or length of service awards] Yes O No **Note:** For more information, see Publication 535, Business Expenses.
☐	☐	H.	Membership Fees Paid |_j Yes ~~\ No **Note:** Excludable if for professional and business-related organizations and reasonable business purpose. Use of athletic or recreation facilities, on employer premises (Includes the use of employer's on-premise facilities to conduct summer sports camps.) **Note:** May be excludable if substantially all use is by employee, spouse or dependent children. Use of third-party owned facilities is generally taxable. For more information, see Publication 15-B.
☐	☐	I.	Moving Expenses] Yes \~\ No **Note:** Exempt (up to limits) if expenses would be deductible if the employee had paid them. These rules are further illustrated in Publication 521, Moving Expenses.
☐	☐	J.	Gift Certificates □ **Yes** □ No **Note:** Gift certificates that are cash equivalent are not excludable from income as de minimis fringe

Notes

Ok	Hag	Item	International
☐	☐	1.	Did the entity make payments of any item of income to a foreign person that is subject to withholding? ^] Yes] No If not, indicate "OK" and skip the International issues section. **Note:** Employees or independent contractors who are not U.S. citizens may be required to furnish their employer with a Form I-9, Employment Eligibility Verification, Form W-4, Employee's Withholding Allowance Certificate, or a W-8 series form. P.O. Boxes from a foreign country are acceptable. The Form W-8 series includes: • W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding; • W-8ECI, Certificate of Foreign Person's Claim That Income is Effectively Connected With the Conduct of a Trade or Business in the United States; • W-8EXPC, Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding; and • W-8IMY, Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding
☐	☐	2.	Did the entity employ resident aliens? _J Yes O No If yes, were withholding income, social security and Medicare taxes followed in the same way as for U.S. citizens?
☐	☐	3.	Did the entity employ nonresident aliens? 2] Yes [_] No If no, indicate "OK" and skip the rest of "International" and continue with "Other Issues" below **Note:** For information on determinina who is a nonresident or resident alien, see Publication 519.
☐	☐	A.	Did any of the nonresident aliens holding an F-1, J-1, M-1 or Q-1 Visa provide No documentation, including copies of the Visa and Form I-9 with supporting documents to support exemption from social security and Medicare taxes? ^\ Yes] **Note:** If this documentation was not provided, social security and Medicare taxes should be withheld from the wages paid to these nonresident aliens. However, a nonresident alien student may be eligible for the student FICA exception under IRC §3121(b)(10).
☐	☐	B.	Did any nonresident aliens have a visa status other than F-1, J-1, M-1 or Q-1? P] Yes P] No If yes, were social security and Medicare taxes withheld as required? HJ Yes [J No **Note:** Nonresident aliens holding other visas, such as an H-1 or any secondary visa are subject to social security and
D	☐	C.	Is federal income tax withheld as required? –^\ Yes fj No **Note:** Nonresident aliens should compete a Form W-4, using Notice 1392 and Form 8233 to claim tax treaty benefits The employer should include procedures for completing Form W-4 and use of Form 8233, Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual, to claim a treaty exemption. See Publication 15 for the rules for completing Form W-4 and claiming a tax treaty exemption on Form 8233.
☐	☐	D.	Do any nonresident aliens claim a treaty exemption using Form 8233? I] Yes ( ] No If yes, were federal income taxes withheld using the current treaty provisions? See Publication 901 for treaty information.
☐	☐	E.	For nonresident aliens who did not claim a treaty exemption, were federal income taxes withheld using the presumption rules described in Publication 515? f~j Yes fJJ No **Note:** If the nonresident alien did not claim a treaty exemption, Federal withholding taxes must be computed based on the completed Form W-4 for the nonresident alien and also by following the steps outlined in Chapter 9 of Publication 15.

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Ok	Flag	Item	International
☐	☐	4.	Does the entity have vendors or outside contractors that are nonresident aliens? ☐ Yes ☐ No **Note:** Generally, withholding is required at 30% (or lower treaty rate) from the gross amount paid to a nonresident alien. Use Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding for payments to nonresident aliens.
☐	**D**	5.	Are payments to nonresident aliens subject to NRA withholding reported on Form 1042-S. ☐ Yes ☐ No and if withholding was required, was a tax return filed on Form 1042?

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Ok	Flag	Item	Other Tax Issues - See Publication 15
D	☐	1.	Employment Tax Filing
☐	☐	A.	**Are all Forms 941 / 944 / 945 filed as required?** ☐ Yes ☐ No ☐ N/A
☐	☐	B.	Are all Forms 941 / 944 / 945 filed by the date required? ☐ Yes ☐ D N/A
☐	☐	C.	Are all Forms 941 / 944 / 945 filed complete and accurate? ☐ Yes ☐ No ☐ N/A
☐	☐	D.	Do wage and withholding amounts for income, social security and Medicare ☐ Yes ☐ No ☐ N/A reconcile between Forms W-3, W-2, and 941? Do the amounts reported on these forms also reconcile to the accounting records? ☐ Yes ☐ No ☐ N/A
D	☐	2.	Independent Contractor Reporting
☐	☐	A.	Does the entity make payments to independent contractors? ☐ Yes ☐ No
☐	☐	B.	Are Forms W-9, Request for Taxpayer Identification Number and Certification, secured from ☐ Yes ☐ No vendors / contractors prior to initial payment? **Note:** Form W-9, or its equivalent, should be secured from all vendors / contractors before any payments are made. Use Form W-9, Request for Taxpayer Identification Number and Certification, to secure the owner's name (if sole proprietor), legal business name, mailing address and taxpayer identification number.
☐	☐	C.	Are Forms W-9 on file for every vendor or independent contractor? ☐ Yes ☐ No
☐	☐	D.	Are all Forms W-9 properly completed? ☐ Yes ☐ No
☐	☐	E.	Are Forms 1099-MISC filed for all vendors/contractors (except for some legally exempt ones) for payments aggregating $600 or more per year? ☐ Yes ☐ No
☐	☐	F.	Does the entity file Form 1099-MISC for payments to individuals, partnerships, and certain corporations? ☐ Yes ☐ No
☐	☐	G.	Does the entity file Form 1099-MISC to attorney recipients (whether or not incorporated)? ☐ Yes ☐ No
☐	☐	H.	Does the entity file Form 1099-MISC for medical and health care payments (including to incorporated recipients)? ☐ Yes ☐ No
☐	D	3.	Backup Withholding If applicable, did the entity withhold Federal income tax on miscellaneous income under backup withholding provisions? ☐ Yes ☐ No **Note:** Notice CP2100 is issued in situations where prior year information returns contained missing or incorrect taxpayer identification numbers and name/identification number mismatches. Backup withholding is required on reportable payments made to a U.S. person if: 1) the U.S. person has not provided its taxpayer identification number (TIN) in the manner required; or 2) The IRS notifies you that the TIN is incorrect. Generally, a TIN must be provided on Form W-9. A payer reports backup withholding on Form 945. For additional information on backup withholding, see Publication 1281, Backup Withholding for Missing and Incorrect Name/TINs and Publication 15, beginning on page 9.

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Ok	Flag	Item	Other Tax Issues - See Publication 15
☐	☐	4.	Does the entity have written policies in place for the following?
☐	☐	A.	Employer-provided passenger automobiles? '] Yes [] No Note: Two types of written policy statements relating to a vehicle provided by the employer qualify as sufficient evidence corroborating the employer's own statement, and therefore will satisfy the substantiation requirements if initiated and kept by an employer to implement a policy of either: 1) No personal use - see the requirements of Regulation §1.274-6T(a)(2). 2) No personal use except for commuting - see the requirements of Regulation §1.274-6T(a)(3). A written policy statement adopted by a governmental unit as to employee use of its vehicles (for example, a city council resolution or a state law) meets these substantiation rules if the conditions in the above cited Regulations are met.
☐	☐	B.	Other listed property or reimbursement of travel expenses? Q Yes f~J No Note: It is not required that the employer have a separate written policy to meet the substantiation requirements for these items. Adequate accounting for these items by employees means the submission to the employer of an account book, diary, log, statement of expense, trip sheet, or similar record maintained by the employer in which the required information as to each element of expenditure or use is recorded at or near the time of the expenditure or use in a manner that conforms to the listed property requirements.
☐	☐	C.	Educational assistance program?] Yes f~J No Note: For benefits to be excludable, an educational assistance plan must be in writing and meet certain other tests. See Publication 15-B.
☐	☐	5.	Is the entity required to file any of the following federal tax or information returns? Note: All forms and instructions are available at http://www.irs.gov/Forms-&-Pubs.
☐	☐	A.	Form 720, Quarterly Excise Tax Return '] Yes Q] No
☐	☐	B.	Form 990, Return of Organization Exempt from Income Tax I J Yes F] No
☐	☐	C.	Form 990-T, Exempt Organization Business Income Tax Return] Yes J No
☐	☐	D.	Form CT-1, Employer's Annual Railroad Retirement Tax Return] Yes] No
☐	☐	E.	Form 1096, Annual Summary and Transmittal of U.S. Information Returns I] Yes '] No
☐	☐	F.	Form 1098-E, Student Loan Interest Statement f~J Yes f~J No
☐	☐	G.	Form 1098-T, Tuition Statement u Yes u No
☐	☐	H.	Form 1099-G, Certain Government Payments . J Yes] No
D	☐	I.	Form 1099-INT, Interest Income u Yes u No
☐	☐	J.	Form 1099-MISC, Miscellaneous Income Q] Yes [ ] No
☐	☐	K.	Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. Q Yes f~J No
☐	☐	L.	Form 8300, Cash Payments over $10,000 Received in Trade or Business Q] Yes f~J No
☐	☐	M.	Form W-2, Wage and Tax Statement u Yes u No
☐	☐	N.	Form W-3, Transmittal of Wage and Tax Statements u Yes f~J No

Notes

Ok	Hag	Item	Other Tax Issues - See Publication 15		
☐	☐	6.	Form W-4, Employee's Withholding Allowance Certificate		
☐	☐	A.	Are Forms W-4 on file for every employee?	☐ Yes	☐ No
☐	D	B.	Are all Forms W-4 secured prior to initial payment?	☐ Yes	☐ No
☐	☐	C.	Are all Forms W-4 properly completed?	☐ Yes	☐ No
☐	☐	D.	Are new Forms W-4 secured each year from all individuals claiming to be exempt from income tax withholding?	☐ Yes	☐ No

Notes

Comment [V31]: Suggest to create a new and separate form similar to this Self Check Compliance for ACA requirements.

You have completed the FSLG Compliance Self-Assessment Tool. If you believe you have compliance issues based on your responses above, you may wish to contact your local IRS Federal, State and Local Government (FSLG) Office for assistance.

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ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Indian Tribal Governments: Report on Recommendations for Outreach and Training - A revision to the Indian Tax Desk Guide

Diane Gange

Stephani Dalrymple

Tino Batt

June 17, 2015

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I. EXECUTIVE SUMMARY

The 2015 report presented by the Indian Tribal Governments subdivision of the Advisory Committee on Tax Exempt and Government Entities (ACT) discusses opportunities for improved and updated outreach to tribal governments. We have specifically addressed the need for updating and expanding the current *Indian Tribal Government Employment Tax Desk Guide*.

Our project began with the concern that inadequate cross-training exists between the Internal Revenue Service ITG division and the broader IRS. This lack of knowledge sharing has had an adverse effect when tribal citizens communicate with the IRS. The 2013 Taxpayer Advocate report noted that other operating divisions of the IRS may not be as familiar or aware of unique characteristics faced by Indian taxpayers. In the same report, the Taxpayer Advocate commended ITG for their outreach and knowledge of tribal tax issues. This supports our concern and highlights the differences in knowledge throughout the IRS of Indian tax issues. We see a need to create a technical assistance product to bridge the gap between the larger IRS areas and ITG. Individual tribal citizens need the same understanding and advocacy when dealing with the IRS that tribal governments have been afforded with their relationship with ITG.

The need for training of ITG field agents to deal with the new Revenue Procedure 2014-35, *Application of the General Welfare Exclusion to Indian Tribal Government Programs That Provide Benefits to Tribal Members* is as important to our committee as the topic of cross-training within the IRS. The Department of Treasury, IRS, and tribal governments around the country worked for numerous years on finalizing guidance to handle the unique tax aspects of tribal assistance programs. Though guidance was well received by most of the tribes, the lack of timely training of agents and the perception that field agents were still auditing under old standards created distrust of the Service. We understand that the IRS wanted to wait until guidance was final before training agents, and that all General Welfare issues were to be addressed by top ITG management, however, communication of this plan to the tribes was not sufficient to calm fears and anger in some parts of Indian Country. Training will be a large step for the future success of the guidance and new regulations that should be developed to address the General Welfare Exclusion Act for continued improvement of relations between the tribes and ITG in this area.

Other topics discussed while trying to determine the scope of this report included:

- Identifying the differences between “mainstream” tax regulations and tax issues unique to tribal citizens;

- Differences in reporting standards and treatment of tax issues for tribal governments and their entities, which have been furthered by new regulations and guidance (For example: Affordable Care Act and Pension Protection Act);
- How basic employment tax issues continue to be an audit finding at many tribes and the cause is distinctly attributed to turnover of financial staff at tribal governments. We examined what training tools exist to address this issue; whether people are aware of them, and whether they are working effectively; and
- We also felt strongly that the ITG website needs to be more readily accessible to tribal governments and tribal citizens as there is not currently a simple or visible link from the IRS main website to the ITG website.

In the beginning, we thought that our project would be to create a reference guide or training tool to address our areas of concerns. When discussing our project with the ITG staff, they recommended we assess the *Indian Tribal Government Employment Tax Desk Guide*. Some of our committee had seen the document years ago; others were not aware it existed. The *Desk Guide* addresses areas of employment tax and reporting. After our review of the *Guide*, we determined that the information was valuable, but out of date and incomplete. The *Guide* could, however, be a starting point from which to expand. Updating the *Guide* for employment tax issues did not go far enough to address our concerns in other areas of tax which affect tribal citizens and governments in unique ways.

Therefore, our recommendation is to update the employment issues addressed by the guide *and* to expand the scope of it to include non-employment issues for tribal entities, and issues of taxation for individual tribal citizens.

We have given two examples of possible edits: 1) updated the Treaty fishing section for new actions taken by the IRS not currently covered by the Desk Guide and 2) added a section on General Welfare Exclusion which would be a good first step in broadening the scope of the *Desk Guide* beyond employment issues. We have also noted other areas which we feel could be included in a major upgrade and expansion of the *Guide*.

The ITG ACT committee recognizes that many of our recommendations take resources that are financial and human. We also recognize that in this time of severe budget cuts, it will be difficult for the IRS and ITG to spare the resources needed to undertake this project. We do hope however, that they will continue to see the importance of outreach to tribal governments stemming from the special government-to-government relationship which exists. This unique relationship requires the IRS to give it their utmost consideration. We hope that educating our tribal finance departments and tribal leaders in the complex tax issues facing tribal governments and continued updated training of

ITG and IRS personnel will lead to a cooperative, collaborative, and trusting relationship between tribes and the IRS.

We wish to thank the ITG staff, especially Christy Jacobs, who spent much time with us and shared ideas of how this project could be successful. We appreciate the work that ITG does and their dedication to Indian Country.

II. INTRODUCTION

Differences in Tax Treatment of Tribal entities/citizens

The *ITG Employment Tax Desk Guide* assists tribal entities in meeting federal employment tax responsibilities. It provides tribal entities with key information and helpful tips for maintaining good records, preparing payroll, and filing and depositing employment taxes. [1] In addition, tribal governments and their entities have access to a site of reference to acquire tax information titled: *Tax Information for Tribal Governments* at http://www.irs.gov/Government-Entities. Through this access, ITG uses partnership opportunities with Indian tribal governments, tribal associations and other federal agencies to respectfully and cooperatively meet the needs of both governments.

For individual tribal citizens, reference guides relating to individual tribal aspects of the tax law and codes are nowhere to be found. Average U.S. citizens may access the IRS website at http://www.irs.gov for tax searches or questions and answers. Citizens of federally recognized tribes are subject to federal income taxes and are taxed in some cases exactly the same as average U.S. citizens (For example: if tribal citizens work for anyone, including themselves, they are subject to the appropriate federal income taxes on the income) and so the IRS.gov website will answer their questions. But for the many special tax circumstances (For example: fishing income, per capitas from gaming and tribal council earnings) answers on the main website are not readily or easily found. Many times when tribal citizens call the IRS “1-800” number to resolve issues or receive clarifications, they are not given proper assistance or information due to the IRS employees not being aware of the differences in tax treatment. Both Tribal governments and tribal citizens should have direct access to accurate answers to questions.

The department needs to recognize the inherent authority of tribes to regulate and tax activities within Indian country. In addition, federal Indian law and policy supports the rights of self-governance for Indian Tribes. Under these same principles, there is a great difference in the relationship between individual tribal citizens and the IRS. There are numerous tax laws which differ either slightly or significantly for tribal citizens. Just as the *ITG Employment Tax Desk Guide* assists tribal entities, it should be expanded and updated to help tribal citizens and the IRS deal with individual tax issues. Promoting an understanding of these laws is in the best interest of the IRS as well as tribal citizens.

Need for Update to *Employment Tax Desk Guide*

ITG has some unique challenges for payroll, independent contractors’ issues, and dividend taxation and reporting. Tribal government employees who process payroll

[1] CHAPTER 1 Introduction to Employment Tax Desk Guide for Indian Tribal Governments Publication 4268 (Rev. 3-2011) Catalog Number 37833J Department of the Treasury **Internal Revenue Service** www.irs.gov.

often times do not have backgrounds in payroll taxation and do not realize that there are many resources to assist them.

Publication 4268, the *ITG Employment Tax Desk Guide,* published by the IRS is a very informative publication that is in need of being updated. The last time that it was revised was March 2011. While much of the information in the guide is still relevant, many of the forms, rates and links within the document are outdated and inaccurate. This document is available on the Internet at http://www.irs.gov/pub/irs-pdf/p4268.pdf. as well as through a link from within the Federal-State Reference Guide Publication 963 (which contains similar information but is not specific to ITG). Though useful, having this information available to tribal organizations with the outdated information contained in the document could be confusing to the users.

The desk guide could also be the beginning of a larger, more expansive reference guide for tribal governments and their citizens. Issues beyond employment taxes could be included to provide useful tools and easy to understand training on General Welfare Exclusions, government pension plans, and tax-exempt bonds. The guide could include examples of best practices that tribes could use to develop ordinances and/or policies. An example can be found in the 2013 ACT report where best practices for implementing general welfare programs were included.

Training Issues

There are factors contributing to the need for an update to the desk guide. A new guide that highlights not only employment tax issues but other areas where differences in the tax treatment of tribes exist would provide a training tool for the Service and for tribal governments. Though ITG has trained its agents on specific tribal issues, new regulations have been established and adequate training has not taken place. Other areas within the Service have no (or very little) training on tribal issues, yet they can have direct contact with tribal citizens on individual tax matters.

ITG has quite an extensive training program for its agents consisting of technical tax issues and the cultural aspects of working with a tribal government. The training discusses tribal sovereignty, history, communication protocols, respect for each tribes' individual way of conducting business, and other relevant topics. Agents within the ITG division are trained on differences in tax treatment of tribal governments; and their entities, and tribal citizens, such as fishing income, per capita, and taxation of tribal businesses. However, the training materials have not been updated in several years and do not contain training on new topics such as General Welfare Exclusion and contributions to 401(k) plans from fishing income. The specific training given to ITG staff is not given to others across the Service and due to size of the Service this is understandable; however, it does cause potential hardships when tribal citizens have specific tax issues that does not conform to the "mainstream" tax laws. There have also

been incidents where tribal citizen tax returns have been flagged as fraudulent due to filing characteristics. The 2013 Taxpayer Advocate Service Report to Congress[1] recommended that the Service "establish a cross-functional working group on issues of Indian individuals, parallel to the ITG function which focuses on tribal entities." The report noted the strength of the ITG advocacy but the lack of awareness of special tax circumstances by other operating divisions of the Service. An updated desk guide could be a tool in this cross-agency education and reference initiative.

Another facet of training to be considered is many tribal governments experience large amounts of staff turnover, with the finance departments not being immune. There is constant turnover in many tribal accounting departments, so this creates a challenge of not only having information available for the new employees, but also a delivery mechanism to put the information and tools in the hands of the new employees. This turnover can leave tribal finance departments without experienced staff who understand even simple tax matters such as employment tax and reporting. Tribes can send staff to training but if the staff is not employed for longer than a year or two, the training brings little benefits to the Tribe. The learning curve becomes even steeper when discussing issues such as Affordable Care Act exemptions, General Welfare Exclusions, and tribal distributions. This lack of qualified staff at the tribal government (or one of its business entities) can lead to misreporting, lack of compliance, and assessment of costly fines and penalties. For the service, this creates work in the compliance and audit areas. This can become a never ending circle of additional work/cost for the Tribe and the IRS.

Once the *Desk Guide* is updated, determining the best means for delivering training to Tribes and Service personnel is the million dollar question. In the current tight budget climate for the Service and Tribes, training and travel seem to be the first expenses reduced. In addition to training/travel dollar cuts, staffing at the Service has been reduced significantly over the past few years with some areas barely having enough personnel to perform essential functions. Outreach and training, though a priority for the Tax Exempt and Government Entities (TE/GE) division of the IRS, is difficult to perform under these conditions. Webinars are quite common and a good alternative to face-to-face training, however, many tribal governments may not have the technical infrastructure needed to participate. Also, many prefer in-person training opportunities. It is also important for notices of training to be received by the appropriate tribal staff, as many times tribal leaders receive training/webinar notices but the information never reaches finance departments. A solution to the training dilemma is critical as the cost of lack of training can be as great as actual training costs.

[1] National Taxpayer Advocate – 2013 Annual Report to Congress – December 31, 2013

III. HISTORY

The Trust Relationship

Tribal government powers include the authority to establish, within tribal boundaries, the form of the tribal government, determine tribal membership, regulate tribal and individual property, levy taxes, establish courts, and maintain law and order. Generally, Indian tribes provide governmental services, such as transportation, education and medical care to Indian tribal citizens.

Although Congress can limit tribal powers of sovereignty, the states cannot. The general rule in the field of Indian law is that unless there is specific delegation of authority provided by Congress, state laws generally do not apply to Indians on tribal land. Thus, Indian tribes are semi-sovereign entities, or distinct, independent political communities within the borders of the states in which they reside. The laws of any state are limited in the ways they can directly effect Indians residing on tribal land, or on the exercise of tribal sovereign power within tribal boundaries.

Tribal sovereignty is the foundation upon which the government-to-government relationship stands. Sovereignty is neither granted by, nor negated by federal statutes, acts or treaties. It is inherent.

Over the years, presidential executive orders have directed federal government agencies, to the extent permitted by law, to "respect Indian tribal self-government and sovereignty, honor tribal treaty and other rights, and strive to meet the responsibilities that arise from the unique legal relationship between the federal government and Indian tribal governments." (Executive Order No. 13175, 65 FR 67249, Nov. 6, 2000.) This relationship is not intended to prevent representatives of the IRS from carrying out official government business.

The second Indian law decision of the Marshall Trilogy was *Cherokee Nation v. Georgia*,[2] which decided whether the Supreme Court had jurisdiction to hear the Cherokee's claim as a foreign nation, under Article 3, Section 2 of the U.S. Constitution. The Supreme Court decision was that the Cherokee Nation is not a foreign nation, because of the U.S. Constitution's "Indian Commerce Clause"[3] that the Court interpreted to give Congress the power to manage the U.S. affairs with the Indian tribes. Accepting Chief Justice Marshall's ruling as precedential law, Indians are not foreign nations, but are referred to as "domestic dependent nations" or tribal nations that have accepted the protection of the United States, yet still retain tribal sovereignty.

[2] 30 U.S. 1 (1831).
[3] U.S. Const., art. 1, § 8 ("The Congress shall have Power To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. . .").

Chief Justice Marshall, reflecting the context of the Court's ruling, considered Indians to be "savage," and in need of receiving the gift of civilization from the white man. Indians are in a "state of pupilage" and the U.S. acts as a guardian to award. Two doctrines result from this state of pupilage: (1) the "duty of protection," and (2) the "guardian/ward relationship." The duty of protection means that the U.S., because it asserts ownership over Indian lands, must protect the Indians. The guardian/ward relationship means that the U.S. holds all land and resources in trust for the Indians: a fiduciary duty. That's why in modern times we call it the "trust relationship." Because the U.S. has a trust relationship with the Indians, it must keep the best interest of the Indians in mind when the federal government deals with them. The trust relationship is perhaps the most pervasive and important doctrine in Indian law.[4]

Formation of ITG

The office of Indian Tribal Governments at the IRS was established to help Indian tribes address their federal tax matters. During the planning and creation of this office, ITG received valuable input from Indian tribal governments and tribal associations to be better able to understand and meet their specialized needs. The overall goal of the office is to use partnership opportunities with Indian tribal governments, tribal associations, and other federal agencies, to respectfully and cooperatively meet the needs of the Indian tribal governments and the federal government, and to simplify the tax administration process.[5]

Lack of Long Term Stability in Tribal Accounting/Legal Departments

Many tribes suffer from a lack of stable administrative infrastructure. Though much progress has been made in this area, some tribes, especially smaller more remotely-located tribes still experience turnover in key financial and legal positions. This turnover impedes implementation of sound financial practices and compliance with even the simplest tax issues. The complexity of current tax matters and how they affect tribal governments only adds to the need for steady and experienced financial personnel. For many years, the most pressing tax matters facing the majority of tribes included employment/independent contract issues, per capitas, payments to tribal council members, and Title 31 gaming issues. More recently there have been new areas for tribes to be aware of and opportunities for them to be engaged in the development/implementation of major tax issues. Treasury and the IRS have held numerous consultation sessions to obtain feedback on critical tax policy. Sessions on tax have become major agenda items at widely attended tribal organization meetings such as National Congress of American Indians and Native American Finance Officers Association. It is the responsibility of tribal leadership to be involved and to have a

[4] The Marshall Trilogy, Tribal Government Leadership Forum. http://outreach.asu.edu/tglf.
[5] CHAPTER 1 Introduction to Employment Tax Desk Guide for Indian Tribal Governments Publication 4268 (Rev. 3-2011) Catalog Number 37833J Department of the Treasury **Internal Revenue Service** www.irs.gov.

working knowledge of the issues. This creates an increased need for training and knowledge of tribal finance and legal staff.

The current *Desk Guide* provides useful information for many employment issues but it does not adequately address other pertinent tax issues faced by today's Tribal governments. Important tax topics such as General Welfare Exclusion, Indian provisions of the Affordable Care Act, government pension plans, tax-exempt bonding, and tribal entity structures all need to be addressed in a document that can be used by tribal officials. An update to the *Desk Guide* which includes these relevant topics could be used by Tribes as a training tool for new financial personnel. It could also be used as a reference point for Tribal leaders to become familiar with matters needing attention or advocacy at a national level. The guide could also provide transfer of information when experienced staff leaves tribal employment.

A consequence of lack of stability and training shows up in the five top issues that ITG identified while performing various levels of compliance checks/audits:

- Noncompliance with reporting of Tribal Council pay,
- Incorrect or unfiled 1099 forms,
- Employment tax filing and deposit issues,
- W-9s and W-4s not being used or updated as needed, and
- Backup withholding issues when no Tax Identification Number is provided prior to payment.

All of these issues can be linked to staff turnover and inconsistency in tribal finance departments. However, they also can be a product of lack of understanding and education on tax issues as they relate to tribal governments. Over the years, many tribal people have felt that tribes and tribal citizens were exempt from all forms of taxation. Many tribal officials felt payments made to tribal citizens (non-gaming distributions) did not require reporting to the IRS. These misperceptions should be addressed in an updated *Guide*.

IV. DUE DILIGENCE

Early on in our project planning, we identified the need for a reference guide to assist the IRS and tribal governments in areas of the tax law that are complex or unique to tribal governments. We discussed creating a new reference guide but were asked by ITG staff to review the current *Indian Tribal Government Employment Tax Desk Guide*. As discussed, this guide has useful information including employees, subcontracts, treatment of certain payments, and tipped employees. It does not address the non-employment issues that were important but does create a starting place for a larger more inclusive reference guide. A distinction between tax issues faced by tribal citizens separated from issues facing tribal governments in a new reference guide would also be useful. We determined that other areas of the *Guide* that weren't already included were:

- Individual Citizen Tax and Reporting Issues
    - Changes to fishing income and allowability of 401K contributions
    - General Welfare Exclusion
    - Trust resources or trust settlement distributions
    - Dividends (Gaming and non-gaming)
    - Income earned from allotted lands
    - Affordable Care Act – Exemption from penalty for no insurance

- Tribal Governments Tax and Reporting Issues
    - Affordable Care Act – Exemption from W-2 reporting of benefit costs
    - Corporate Tax – structures for tribal entities
    - 401K – ERISA – Pension Protection Act – Government plans and what employees qualify

- Introductory Section
    - In the introduction section of the current *Desk Guide*, there is reference to whether federally recognized tribal governments are subject to employment taxes. This section should be expanded to address the perception that tribes and their citizens are tax exempt, clarify exactly under what circumstances tribal entities and citizens are taxed, and provide a reference for Tribal leaders.

Sample Updates to Two Areas of the Desk Guide

We're offering herein two examples of areas to update and expand the *Desk Guide.* The first area is treaty fishing income. This section is currently included in the *Guide*; however, recent IRS activity has expanded issues related to the topic. The second area is General Welfare Exclusion. The GWE issue has created much dialogue in Indian

country and any technical assistance that can be provided to either the IRS or Tribes is extremely necessary. Our hope is this added clarification and training can alleviate some of the misconceptions of the IRS in Indian Country.

Sample Update #1: Treaty Fishery

"Treaty fishery" is the fishing and shellfish rights preserved in a tribe's treaty, a federal executive order, or an act of Congress. It includes activities such as harvesting, processing, transporting, or selling, as well as activities such as management and enforcement.[6]

B&O tax Fishing Rights-Related Activities. Any income derived by a member of an Indian tribe (either directly or through a qualified Indian entity) or by a "qualified Indian entity" (defined later in this chapter) from a fishing-rights related activity of that member's or entity's tribe is exempt from federal and state taxation (For example: income tax, income tax withholding, FICA, unemployment tax, and self-employment tax).[7]

The gross income directly derived from treaty fishing rights-related activity is not subject to state tax.

This exclusion from tax is limited to those businesses wholly owned and operated by Indians or Indian tribes who have treaty fishing rights. If a business wholly owned and operated by them deals with treaty and non-treaty fish, this exclusion from tax is limited to the business attributable to the treaty fish.

"Wholly owned and operated" includes entities that meet the qualifications under 26 U.S.C. 7873, which requires that:

- Such entity is engaged in a fishing rights-related activity of such tribe
- All of the equity interests in the entity are owned by qualified Indian tribes, members of such tribes, or their spouses;
- Except as provided in the code of federal regulations, in the case of an entity which engages to any extent in any substantial processing or transporting of fish, ninety percent or more of the annual gross receipts of the entity is derived from fishing rights-related activities of one or more

[6] http://dor.wa.gov/content/FindTaxesAndRates/RetailSalesTax/Indians/IndianTaxGuide/default.aspx#SectionTitle

[7] CHAPTER 3 Treatment of Certain Payments; Employment Tax Desk Guide for Indian Tribal Governments Publication 4268 (Rev. 3-2011) Catalog Number 37833J Department of the Treasury **Internal Revenue Service** www.irs.gov

qualified Indian tribes each of which owns at least ten percent of the equity interests in the entity; and

- Substantially all of the management functions of the entity are performed by members of qualified Indian tribes.

Sales and use tax. The retail sales tax and use tax do not apply to the services or tangible personal property for use in the treaty fishery, regardless of where delivery of the item or performance of the service occurs. Gear, such as boats, motors, nets, and clothing, purchased or used by Indians in the treaty fishery is not subject to sales or use tax. Likewise, retail services in respect to property used in the treaty fishery, such as boat or engine repair, are not subject to sales tax.

Note: In this context, "transporting" is the shipment of fish for profit as a separate commercial activity, and not the mere carrying of fish from waters where they are harvested to the point of sale or processing.

Sales to nonmembers. Treaty fish and shellfish sold by members of the tribe are not subject to sales tax or use tax, regardless of where the sale takes place due to the sales and use tax exemption for food products.

Government-to-government agreement. A tribe and the department may enter into an agreement covering the treaty fishery and taxable activities of enrolled members, in which case the terms of the agreement govern.

Certain Payments. We will discuss how certain payments are treated. Some of them are specific to Indian tribes, while others are not. (For example, payments made from fishing rights-related activities.)

Wages are not exempt if paid by an employer who is not a member of the same tribe or is not a qualified Indian entity. Wages are also not exempt if paid to an employee who is not a member of the tribe whose fishing rights are exercised. Tribal members must fish in their own waters to be exempt.

Fishing rights-related activity is an activity (including aquaculture) directly related to harvesting, processing, or transporting fish harvested in the exercise of recognized fishing rights of such tribe or to selling fish, but only if substantially all of the harvesting was performed by members of the tribe.

A recognized fishing right must have been secured as of March 17, 1988, by a treaty between the tribe and the United States, by an Executive Order, or an Act of Congress.

As employers exercising fishing rights-related activities they must:

- Verify their status as a qualified Indian entity.
- Verify their employee's proof of tribal membership.
- Verify time allocated to fishing versus non-fishing activity. For example, consider a game warden that is responsible for protecting other wildlife and has other duties, as well as patrolling the treaty waters of his tribe. His employer should verify the percentage of time he engages in fishing rights-related activities of his tribe.
- Maintain records to support each employee's time allocation.
- Maintain records to support the 90 percent gross receipts rule (defined later in this chapter).

Tax Return Preparation

- Do not include exempt wages on Form 941, Form 940, or Form W-2.
- Wages paid for non-fishing activities are subject to all applicable employment taxes and employment tax reporting, including Form W-2.
- If only fishing rights-related income is paid to an individual, no Form W-2 is required.
- Letters stating the amount and tax-exempt nature of their wages may be issued to an employee to be used for various non-tax purposes, such as bank loans.

Note: If a processor or transporter fails to meet the 90 percent rule, all income from that year is taxable.[8]

Special Definitions

A "qualified Indian entity" is 100 percent owned by a federally recognized Indian tribe or tribal members, and substantially all management functions are performed by tribal members. It may be jointly owned by more than one tribe or members of more than one tribe.

90 percent Rule for processors and transporters: If the entity engages to any extent in any substantial processing or transporting of fish, then at least 90 percent of the annual gross receipts of the entity must be derived from the exercise of protected fishing rights of tribes whose members own at least 10 percent of the equity interests in the entity.

[8] Pg16 Reference Desk Guide Publication 4268 (Rev. 3-2011) Catalog Number 37833J Department of the Treasury Internal Revenue Service www.irs.govwww.irs.gov/pub/irs-pdf/p4268.pdf

Examples of categories of tribal employees whose wages may be exempt or partially exempt: [9]

- Fishers, processors (including smoking), transporters
- Hatchery workers
- Environmental and conservation workers
- Enforcement staff and tribal court personnel
- Support staff (That is: secretary, accounting, and payroll)
- Program director, executive director
- Fisheries biologist
- Fisheries aide
- Fishery and habitat policy analysts
- Water quality biologist
- Habitat inventory and assessment technician
- Legislative analyst
- Information and education services
- Data analyst
- Policy analyst
- Public information staff

401K contributions from Tax exempt income: Because of the IRS' negative position on using IRAs or 401(k) plans to cover tribal members engaged in fishing rights-related activities, some tribes have turned to annuities or non-qualified deferred compensation plans to provide their members with some type of retirement savings funds. As noted below, the final regulations depart from the prior position taken by the IRS and open up options to the tribal governments when designing their retirement benefits plans. Section 415 of the Internal Revenue Code limits the annual amount of contributions that may be made for a participant in a defined contribution plan. It also limits the annual amount of benefits that may be paid to participant in a defined benefit plan. The IRS section 415 rules require that a participant have compensation that is included in gross income. Under the new rule, Indian tribal governments and individual tribal members conduct fishing activities to generate revenue, protect critical habitats, and preserve tribal customs and traditions. Various treaties, federal statutes, and presidential executive orders reserve to Indian tribal members the right to fish both on and off reservations. Income derived from fishing rights-related activities is exempted from income and employment taxes.

[9] pg17 Reference Desk Guide Publication 4268 (Rev. 3-2011) Catalog Number 37833J Department of the Treasury Internal Revenue Service www.irs.govwww.irs.gov/pub/irs-pdf/p4268.pdf

Since fishing rights-related income is not subject to income tax, there has been a question as to whether this income is included as compensation for purposes of section 415. Fishing rights-related activity with respect to Indian tribes includes any activity directly related to: harvesting, processing or transporting fish harvested in the exercise of a recognized fishing right of the tribe; or selling such fish but only if substantially all of such harvesting was performed by members of such tribe.

The IRS issued regulations clarifying that certain fishing rights-related income is included in the section 415 definition of compensation and may be contributed to a qualified retirement plan. Income paid to an Indian tribal member as payment for fishing rights-related activities is not to be excluded from the definition of compensation merely because it is not subject to income tax.

This new regulation is one example of where the needs of both individual tribal citizens and tribal governments could be addressed in a combined updated *Tribal Reference Guide*.

Sample Update #2: General Welfare Exclusion

After receiving much criticism from Tribal leaders and subsequently gaining a new understanding of the unique legal status of tribal governments, Treasury and the IRS realized that tax treatment of benefits to citizens needed to be examined. After much consultation, guidance was issued and additional clarification was provided. The following guidance exists with regards to taxation of services rendered to tribal citizens and the tax exclusion of such benefits.

The General Welfare Exclusion doctrine applies to certain payments made on behalf of a citizen under a governmental program designed to promote the general welfare of the citizen. These payments have been held by the IRS not to be included in a recipient's gross income if the following conditions are met:

- Payments made pursuant to a governmental program,
- Payments for the promotion of the general welfare (that is, based on need), and
- Payments that don't represent compensation for services.

In addition to a Tribal program qualifying under the General Welfare Exclusion, the Service provided further guidance on tax exemption for tribal programs under Revenue Procedure 2014-35, *Application of the General Welfare Exclusion to Indian Tribal Government Programs that Provide Benefits to Tribal Members*. The revenue procedure provided general guidelines for tax exemption as well as safe harbor provisions for specific types of programs.

(1) General criteria*.* To qualify for exclusion under this revenue procedure, a benefit must meet the following requirements:

- The benefit is provided pursuant to a specific Indian tribal government program;
- The program has written guidelines specifying how individuals may qualify for the benefit;
- The benefit is available to any tribal member, qualified nonmember, or identified group of tribal members or qualified nonmembers (For example: veterans) who satisfy the program guidelines, subject to budgetary restraints;
- The distribution of benefits from the program does not discriminate in favor of members of the governing body of the tribe;
- The benefit is not compensation for services; and
- The benefit is not lavish or extravagant under the facts and circumstances.

(2) Specific benefits. Benefits provided under the following programs are presumed to be tax exempt. The benefits listed in the parenthetical language in section 5.02(2) are illustrative, not an exhaustive list. A benefit may qualify for exclusion from gross income under this revenue procedure even though the benefit is not expressly described in the parenthetical language provided that it meets all other requirements of this revenue procedure.

- Housing programs.
- Educational programs
- Elder and disabled programs
- Other qualifying assistance programs
- Cultural and religious programs.

(3) Benefits provided by a tribe that are presumed not to be compensation for services. Except as provided in this section 5.03, section 5.01 of this revenue procedure does not apply to benefits that are compensation for services. However, section 5.01(2) of this revenue procedure applies to benefits provided under an Indian tribal governmental program that are items of cultural significance. These items are not lavish or extravagant under the facts and circumstances or nominal cash honoraria provided to religious or spiritual officials or leaders (including but not limited to medicine men, medicine women, and shamans) to recognize their participation in cultural, religious, and social events (including but not limited to pow-wows, rite of passage ceremonies, funerals, wakes, burials, other bereavement events, and subsequent honoring events). The Service will conclusively presume that individual need is met for

the religious or spiritual officials or leaders receiving these benefits and that the benefits do not represent compensation for services.[10]

[10] Revenue Procedure 2014-35 Application of the General Welfare Exclusion to Indian Tribal Government Programs that Provide Benefits to Tribal Members

V. CONCLUSIONS

Based on our review of the current *Indian Employment Tax Desk Guide*, discussion with ITG staff, and our knowledge of the need for updated information in Indian Country, the ACT committee makes the following detailed recommendations.

Update the Indian Employment Tax Desk Guide
As mentioned in the due diligence section of our report, a complete update of the *Desk Guide* is needed. This update should include the following:

1. Update current *Desk Guide* information for changes to including tax law/regulations.(Example in due diligence section regarding Treaty Fishing Income)

2. Expand the *Desk Guide* to include non-employment type issues for tribal entities and issues of importance to individual tribal citizen taxpayers, such as General Welfare Exclusion, Affordable Care Act issues, and Tribal business structures (Example in Due Diligence section about General Welfare Exclusion)

Distribution of the Desk Guide to tribal entities/citizens
At present, it is difficult for tribal citizens to obtain access to the *Indian Tribal Government Desk Guide*, and many tribal citizens are not even aware that this resource is available to them. Accessing the *Desk Guide* through the main IRS website requires specific knowledge of the name or publication number associated with the guide, and even then it is not easily recognizable for a tribal citizen who is new to the site. As this is an invaluable resource for tribal entities, it must be made more readily available for their use. The following recommendations for distributing the *Desk Guide* to tribal entities are:

1. Create a section on the home page of the IRS website with a shortcut to the ITG Desk Guide, allowing tribal members easy access to this reference. Include links to specific sections, as tribal members may not be familiar with the contents of the guide.

2. Mail postcards to all of the federally registered Indian tribal governments, marked “Attention: Accounting.” On these postcards, provide a link to the *Desk Guide* and a description of what it is and how it can be used. Also include a link to sign up for the Federal, State & Local Governments newsletter as well as the Indian

Tribal Governments newsletter, to ensure that tribal members will receive these resources as well.

3. Create and maintain a presence on Facebook, utilizing tribal members' familiarity with social media to present useful information such as links to the *Desk Guide*, information about upcoming events and deadlines, as well as tips and tutorials on tribal accounting.

4. Schedule webinars giving guidance on completing tax forms and using QuickBooks, and publicize the dates and sign up information on the IRS website, in the ITC newsletter, and on social media.

5. Create and disseminate YouTube videos and other tutorials on basic accounting processes (For example: tax forms and bookkeeping) to provide tribal members with step-by-step guides and troubleshooting resources.

Training Opportunities

An update to the Desk Guide will be extremely helpful and a valuable resource. It is imperative though that continued training opportunities be developed, maintained, and presented. We recommend the following:

1. Continued participation by key ITG management at annual or semi-annual meetings of tribal organizations such as National Congress of American Indians and Native American Finance Officers Association to update tribal leaders on important tax topics.
2. Explore a partnership with Native America Finance Officer Association to provide webinars. NAFOA has exceled recently in presenting relevant and timely webinars which are virtually attended by many tribal finance personnel as well as tribal leaders.
3. Train ITG field agents on new guidance provided in recent IRS actions such as General Welfare Exclusion. The fact that training was not given until finalized guidance was issued and Indian Country's perception that lack of training in this area has created audit issues continue to create mistrust between the tribes and IRS.
4. Update new field agent training.
5. ITG offers basic training on employment and compensation related topics. An extension of the training opportunities to include other "hot" topics which are of importance to Indian Country would be helpful.

Central call center for Tribal Entities and Individual Tribal Members

The ITG office offers a single point of contact for assistance and services to tribal entities which addresses issues and provides guidance. Creating a central call number directly to ITG or an IRS employee with knowledge of tribal tax issues for individual tribal citizen assess offers a critical interface for effective questions and answers. This call center could interact with the tribal citizen on a personal level, and make a quick reference to an updated *Desk Guide* or reference guide for specific information which is relevant to the tribal citizen tax issue.

ADVISORY COMMITTEE ON TAX EXEMPT AND GOVERNMENT ENTITIES (ACT)

TAX EXEMPT BONDS: DOING MORE WITH LESS – BALANCING RESOURCES AND NEEDS

Katherine A. Newell
Floyd C. Newton, III
Lorraine M. Tyson

June 17, 2015

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INTERNAL REVENUE SERVICE
ACT COMMITTEE
REPORT OF THE SUBCOMMITTEE ON TAX EXEMPT BONDS
June 17, 2015

DOING MORE WITH LESS – BALANCING RESOURCES AND NEEDS

I. EXECUTIVE SUMMARY

The market for tax-exempt bonds has expanded to include, along with "traditional" projects for state and local governments, a broad range of private activity bonds and complicated financing structures that present complex legal and factual issues that require more resources including time, expense and levels of expertise. At the same time as the resources necessary to understand and analyze the complex rules governing issuance and use of tax-exempt financing have contracted, economic conditions have strained the budgets of issuers and the IRS alike. In this report, the Subcommittee on Tax-Exempt Bonds of the IRS Advisory Committee on Tax-Exempt and Governmental Entities is identifying possible approaches that the Tax-Exempt Bond Division of the IRS Division on Tax-Exempt and Governmental Entities may implement to ease the burden on both issuers and IRS personnel in analyzing and complying with the complex issues that tax-exempt bond financing presents.

II. INTRODUCTION

The market for tax-exempt bonds was once a relatively uniform and sedate market, composed almost exclusively of long term, fixed rate bonds (with a very low incidence of defaults or other issues), issued to finance "traditional" projects for state or local governments. There was very little trading of these bonds. While some of these types of bonds still are issued today, there are many other types of bonds which now make up the tax-exempt market. There are multiple types of variable rate bonds, some with "put" features that trade essentially like commercial paper. Interest rates may be determined by re-pricing in the current market, or by spreads to the London Interbank Offered Rate (LIBOR) or other indices. The types of projects financed may now be far from "traditional" governmental projects like courthouses, roads and schools. There are

bonds of all credit qualities, and third party credit and liquidity enhancements may be used depending on the type of issue. Many more bonds are actively traded.

At the same time, state and local issuers are facing other challenges. Tax revenues, whether from property taxes or other sources, are not the stable, growing source of revenue they once represented. During the recent financial distress, tax digests in many jurisdictions dropped to levels not seen in decades, as did other revenue sources like sales taxes, user fees and similar charges. These swings in economic cycles have dramatically affected the resources of issuers of tax-exempt bonds and have led issuers to enter into arrangements that may impact the tax-advantaged status of these bonds.

In a similar fashion, these changes have imposed significant burdens on the IRS, and in particular on the Tax-Exempt Bond Division in Tax-Exempt and Governmental Entities. The proliferation of different types of bonds and the increasing complexity of bond issues has strained TEB. The time involved to understand issues presented by these new complex products and non-traditional uses of bond-financed facilities has made providing guidance increasingly difficult, and has imposed substantial burdens on TEB personnel in responding to TEB's Voluntary Closing Agreement Program and in conducting examinations of tax-exempt bonds. Congressional experimentation with tax credit bonds of various types, direct pay bonds, economic recovery bonds, and other similar programs, has further increased the workload of an already over-burdened TEB.

Like state and local issuers, the IRS, and TEB in particular, is facing unprecedented budgetary challenges. The number of people in TEB has decreased from approximately 102 to 76 since 2009. Money available for outreach programs, seminars, educational efforts and other similar programs has decreased. Because of the increased complexity of the market, the need for improved training and communication among personnel in TEB has increased, while funds available for training have decreased. Communication is especially difficult since TEB's workforce is scattered throughout the country. The lack of additional formal guidance has also imposed burdens on TEB in terms of its seeking to take consistent positions on questions which arise during the examination process or otherwise. Finally, TEB faces competition among other areas of TEGE, and other areas of the IRS outside of TEGE, for the limited resources available to the IRS.

These challenges point to the need for a re-examination of many of the "old" ways of doing things. TEB, like other areas of the IRS, must adopt new methods of operating which provide more guidance to issuers and other customers, thereby increasing ongoing compliance and reducing the burden on examinations. There will always be a need for examinations, but the agents and examiners need to be better trained, more focused in their inquiries and have the ability to share knowledge and experience in ways that will reduce the burden on both TEB and issuers and provide greater

consistency of results. To these ends, our report makes recommendations regarding increased use of knowledge management tools inside of TEB, increased use of programs like the Industry Issue Resolution and Industry Director Directives programs used by the Large Business and International Division and Small Business and Self-Employed Division to provide more guidance, and other similar steps to improve efficiency in a time of increased complexity and dwindling resources. TEB itself has begun efforts in this area through its Employee Development Team and our report hopes to build on those efforts.

III. DUE DILIGENCE

In gathering information for this report, the TEB Subcommittee researched the use of the Industry Issue Resolution and Industry Director Directives programs by the Large Business and International Division and the Small Business and Self-Employed Division and discussed with TEB representatives the feasibility of TEB's employing and benefitting from these programs. TEGE leadership provided the entire ACT membership information about the knowledge management, knowledge sharing and efficiency initiatives being undertaken throughout TEGE and TEB representatives provided this Subcommittee with specific initiatives being considered within TEB. Based on this information and personal experiences, the TEB Subcommittee developed the recommendations made in this report.

IV. RECOMMENDATIONS

A. INCORPORATION OF BEST PRACTICES FROM OTHER IRS DIVISIONS

There are two IRS programs that relate to business taxpayers that the TEB subcommittee believes can be adapted for use by TEB to achieve more efficiency and effectiveness. The Industry Issue Resolution Program aims to resolve issues by providing published guidance with respect to frequently occurring, complicated or heavily factual issues that taxpayers may rely on in taking positions on tax returns with the ultimate goal of lessening the time and resources that need to be expended in the audit process. The Industry Director Directive Program is utilized to provide guidance on administrative and compliance matters including the conduct of audits.

1. Industry Issue Resolution Program

Overview. The IRS Industry Issue Resolution (IIR) program provides business taxpayers, industry associations and other interested parties an opportunity to submit frequently burdensome or disputed tax issues for possible resolution through published

or administrative guidance. This program supports the goal[1] of the IRS and of the Office of Chief Counsel to provide guidance before tax returns are filed with a view to lessening the time and resources that need to be expended in the audit process and using both IRS and taxpayer resources more efficiently. The IIR program is currently utilized by the Large Business and Industry (LB&I) Division[2] and the Small Business and Self Employed (SB/SE) Division.

Background. In Notice 2000-65,[3] the IRS announced the "Industry Issue Resolution Pilot Program." The goal of the pilot program was to create a procedure to address frequently disputed tax issues that are common to a significant number of large or mid-size business taxpayers through pre-filing guidance rather than post-filing examination. After evaluating the success of the pilot program, the IRS announced that the IIR program would be permanent in Notice 2002-20.[4] In Notice 2002-20, the IRS also expanded the IIR program to include small businesses, and to address opportunities to reduce burdens for all business taxpayers. Revenue Procedure 2003-36[5] supplemented and superseded Notice 2002-20 and is the current guidance for submitting issues for consideration under the IIR program.

Issues appropriate for the IIR program. Business taxpayers served by SB/SE and LB&I are eligible to use the IIR program. Revenue Procedure 2003-36 provides that the issues most appropriate for consideration under the IIR program generally will have two or more of the following characteristics[6]:

1. The proper tax treatment of a common factual situation is uncertain.
2. The uncertainty results in frequent, and often repetitive, examinations of the same issue.
3. The uncertainty results in taxpayer burden.
4. The issue is significant and impacts a large number of taxpayers, either within an industry or across industry lines.

[1] IRM 32.4.3.1 and Fact Sheet: Industry Issue Resolution (IIR) Program (March 2012) ("IIR March 2012").
[2] LB&I is the successor to the Large and Mid-Size Business Division (LMSB) and portions of the Internal Revenue Manual and other IRS documents, like Rev. Proc. 2003-36 which relates to the IIR program, still refer to LMSB.
[3] 2000-2 C. B. 599.
[4] 2002-1 C.B. 796.
[5] 2003-1 C.B. 859.
[6] Section 3.01 of Rev. Proc. 2003-26 and IRM 32.4.3.2.1 (1). Note: Fact Sheet: Industry Issue Resolution (IIR) Program (March 2012) states that issues for consideration under the IIR Program will have at least two of such characteristics.

5. The issue requires extensive factual development, and an understanding of industry practices and views concerning the issue would assist the IRS in determining the proper tax treatment.

Issues that (a) are unique to one or a small number of taxpayers, (b) involve transactions that lack a *bona fide* business purpose or that have a significant purpose of improperly avoiding or reducing federal income tax, or (c) involve transfer pricing or international tax treaties are not considered appropriate for the IIR program under Revenue Procedure 2003-36[7].

IIR Process. Section 4.01 of Revenue Procedure 2003-36 contains information on how to submit an issue for IIR consideration. The IRS also describes the IIR submission procedures in the Internal Revenue Manual[8] and on its website at http://www.irs.gov/Businesses/IIR-Submission -Procedures.

Submission. The guidelines for submission provide that issues may be submitted for resolution at any time of the year and that there is no required format or form for submission. However, the submission should include:

- an issue statement,
- a description of why the issue is appropriate for the IIR program,
- an explanation of the need for guidance,
- the estimated number of taxpayers affected by the issue, and
- the name and the telephone number of a person to contact if additional information is needed.

The submission may also include a recommendation of how the issue may be resolved.[9]

All submissions will be made available for public inspection and copying in their entirety so submissions should not include confidential or taxpayer specific information.[10]

Selection. LB&I and SB/SE review and evaluate the issues submitted under the IIR program at least semi-annually, generally after March 31 and August 31 of each year.

[7] Section 3.02 of Rev. Proc. 2003-26, IRM 322.4.3.2.1 (2) and FS IIR March 2012. Issues that are not under the jurisdiction of LB&I and SB/SE are also not considered appropriate for the IIR program.
[8] IRM 32.4.3.2.3.
[9] Section 3.02 of Rev. Proc. 2003-26, IRM 32.4.3.2.3.
[10] Submissions may be identified as a "Revenue Procedure 2003-36- IIR Program Submission" and emailed to IIR@irs.gov or mailed or faxed to the Office of Pre-Filing and Technical Services LB&I Division.

After review and evaluation, LB&I and the SB/SE may recommend that an issue be included on the Treasury Department's and the IRS Guidance Priority List for the upcoming year or on periodic updates to the Guidance Priority List. However, a recommendation by LB&I and SB/SE does not ensure that the issue will be selected. Recommendations from other sources, whether the requested guidance promotes sound tax administration, and the appropriateness of the issue for the IIR program are among the factors considered in determining whether the guidance should be included on the Guidance Priority List.[11] Inclusion of an IIR item on the Guidance Priority List does not guarantee that published guidance on the item will be issued.

Guidance. An LB&I or SB/SE representative will notify the submitter if the issue is not selected for the IIR program and at least annually, the IRS will publically announce the issues reviewed under the IIR program and selected for the Guidance Priority List. After an issue is selected, a team is formed consisting of representatives of the IRS, Treasury and Chief Counsel and as necessary, other personnel or outside experts.[12] The team is responsible for gathering facts; meeting with taxpayers, industry associations, and other interested parties; analyzing relevant information; and proposing a resolution for the issue. Submitters and other interested parties may also participate in the process through meetings with the IIR team and by providing the team with additional information that can be helpful in educating the team about the industry and assisting in the development of the issue. Resolution of an issue is generally through published guidance, usually a revenue ruling and/or revenue procedure, but may include administrative guidance.[13]

Examples of IIR guidance. The published guidance that has been issued as a result of IIR submissions (IIR guidance) includes revenue procedures, revenue rulings and notices that provide safe-harbors or other guidance that may be used by a business taxpayer in determining how to report a particular item on a tax return. For example, IIR guidance includes revenue procedures that provide guidance on the permissible use and method of statistical sampling or other methods for determining certain deductions or allowances rather than actual amounts.[14] They also provide safe harbors or guidance for properly determining items that must be capitalized[15] or determining that

[11] IRM 32.4.3.3.
[12] IRM 32.4.3.4.
[13] FS IIR (March 2012).
[14] Rev. Proc. 2011-42, 2011-2 C.B. 318 (use of statistical sampling); Rev. Proc. 2002-41, 2002-1 C.B. 1098 (maximum amount deemed substantiated without records for payments made to construction employees who also furnish welding or mechanics rigs); Rev. Proc. 2003-22, 2003-1 C.B. 577 (allowing family day care providers to use standard meal and snack rates in lieu of actual cost in deducting the cost of food provided to children in their care).
[15] Rev. Proc. 2011-43, 2011-37 IRB 326 (when costs of maintenance, replacement and improvement of electric transmission and distribution property must be capitalized) ; Rev. Proc. 2011-28, 2011-1 C.B. 743

depreciation of an item is permissible.[16] Other IIR guidance includes revenue procedures for determining allowable recovery periods for depreciation[17] and for using a specific method of accounting.[18] Although the focus of the IIR program is providing pre-tax-return filing guidance, IIR Teams have also resolved IIR issues by developing administrative guidance for field agents and examiners on conducting audit of complex, fact intensive issues. Directives that the IRS has identified as a product of the IIR program include directives regarding the amount of allowable bank bad debt deductions, hedging of variable annuity benefits and mark-to-market valuation.[19] These directives are also a product of the Industry Director Directive Program discussed in Section IV.A.2 below. A complete list of IIR guidance is available at www.irs.gov/Businesses/IIR-Guidance-Issued.

The National Association of Bond Lawyers, the Government Finance Officers Association, the American Hospital Association and other interested parties representing municipal market participants have submitted comments and requests for guidance on a wide range of topics over time. The Treasury Department and the IRS have responded in a number of ways to these comments. Most recently, the IRS released Notice 2014-67[20] providing a safe-harbor for accountable care organizations and Announcement 2015-02[21] provides a procedure for certain non-profit organizations whose Section 501 (c)(3) status has been revoked for failure to file Form 990s for three consecutive years.to obtain reinstatement of exempt status. Clearly Treasury and IRS listen and respond to industry representative comments. However, adoption by TEB of the IIR program would include procedures such as prioritizing issues, setting due dates for response[22] and interacting with industry experts that provide a framework for resolving issues more quickly and effectively. In addition, the IIR program could provide

(determining the amount of wireless telecom network asset repair and replacement costs that must be capitalized).

[16] Rev. Rul. 2001-60, 2001-2 C.B. 587 (permitted depreciation of golf course land improvements).

[17] Rev. Proc. 2011-22, 2011-1 C.B. 737; Rev. Proc. 2011-27, 2011-1 C.B. 740.

[18] Rev. Proc. 2008-23, 2008-1 C.B. 664 ("vehicle-pool method" alternative to LIFO for resellers of cars and light-duty trucks); Rev. Proc. 2006-14, 2006-1 C.B. 350 (use of replacement cost of heavy equipment parts in determining cost of inventory under LIFO); Rev. Proc. 2003-20, 2003-1 C.B. 445 (use of "core alternative valuation" method to value inventory of cores by remanufacturers and resellers of rebuilt motor vehicle parts that use the lower of cost or market method of inventory valuation).

[19] LB&I Directives: (i) Related to Section 166 Deductions For Eligible Debt and Eligible Securities (October 23, 2014) (Bank Bad Debt Deduction under Section 166); (ii) Related to Partial Worthlessness Deduction For Eligible Securities Reported by Insurance Companies – IRC Section 166 (July 30, 2012); (iii) For Hedging of Variable Annuity Guaranteed Minimum Benefits (GMxB) by Insurance Companies IRC Section 446 (July 17, 2014); (iv) IRC Section 475: Field Directive related to Mark-to-Market Valuation, Frequently Asked Questions for IRC Section 475 are just a few examples of directives that relate to issues raised under the IIR program.

[20] 2014-46 IRB 822.

[21] 2015-3 IRB 324.

[22] IRM 32.4.3.3.

a framework for identifying ways of streamlining audits of issues within TEB's jurisdiction.

2. Industry Director Directives

Industry Director Directives are utilized by LB&I[23] as a means to provide administrative guidance to ensure consistent tax administration and address matters related to internal division operations. The Commissioner LB& I has authority to administer and enforce the Internal Revenue Code and may delegate to directors of LB&I certain authority on matters involving cases and resources[24] in order to (1) address administrative and compliance actions, (2) provide instructions for planning and conducting examinations in areas of unsettled law, (3) provide interim technical advice for examiners, (4) address time and resource allocations, and (5) mandate the use of specific audit techniques in developing issues.[25]

LB&I has utilized IDDs for almost 15 years to provide IRS personnel with guidance on a variety of issues. Examples include guidance on simplifying or outlining the method of determining the amount of a deduction or credit[26]; the method by which a taxpayer allocates certain costs under specified conditions[27]; conducting examinations involving a change in accounting method[28]; accepting mark to market values as reported by a taxpayer under specified conditions [29]; determining whether a taxpayer has the benefits

[23] *See* footnote 2 *supra*.

[24] The Commissioner's authority to administer and enforce the Internal Revenue Code under Treasury Order No. 150-10 is delegated to Division Commissioners under Delegation Order 1-23 (formerly DO-193 Rev. 6), who may further delegate to Division Directors, certain authorities on matters involving cases and resources.

[25] IRM 4.51.2.2.2

[26] See e.g., LB&I Directives: (i) Related to Section 166 Deductions For Eligible Debt and Eligible Securities (October 23, 2014) (Bank Bad Debt Deduction under Section 166); (ii) Related to Partial Worthlessness Deduction For Eligible Securities Reported by Insurance Companies – IRC Section 166 (July 30, 2012); Guidance for Computing and Substantiating the Credit for Increasing Research Activities under Section 41 of the Internal Revenue Code for Activities involved in Developing New Pharmaceutical Drugs and Therapeutic Biologics.

[27] See e.g., LB&I Directive Related for Allocating Mixed Service Costs (MSC) Under IRC Section 263A to Certain Self-Constructed Property (October 14, 2014) (electric and natural gas utilities).

[28] See e.g., LB&I Directives: (i) Extending Transition Rules and the Scope Limitation Waiver for Taxpayers Adopting the Safe Harbor Method of Accounting for Electric Transmission and Distribution Property LB&I Directives 1,2 & 3 (November 4, 2011, May 2, 2013 & September 3, 2014); (ii) For Taxpayers Changing to the Method of Accounting Provided in Rev. Proc. 2013-24 for Steam or Electric Generation Property; (iii) For Taxpayers Who adopted a Method of Accounting Relating to the Conversion of Capitalized Assets to Repair Expense under IRC Section 263 (a); (iv) Relating to Telecommunication Carriers Change in Method of Accounting Relating to Conversion of Capitalized Assets to Repair Expense Under IRC263 (a); (v) Regarding Consent of Director Provisions for a Voluntary Change in Method of Accounting under Rev.Proc.2011-14, APPENDIX Section 15.11 (November 9, 2011).

[29] LB&I Directives: (i) For Hedging of Variable Annuity Guaranteed Minimum Benefits (GMxB) by Insurance Companies IRC Section 446 (July 17, 2014); (ii) I.R.C. Section 475: Field Directive related to Mark-to- Market Valuation, Frequently Asked Questions for I.R.C. Section 475.

and burdens of ownership for purposes of claiming a deduction[30]; examining certain payments in connection with the acquisition of businesses[31] the method of determining depreciation allowable to a taxpayer[32]; and the procedures to follow in conducting an examination.[33]

As discussed in Section IV.A.1, some IDDs have resulted from IIR submissions that focused attention on issues appropriate for IIR submission, i.e. frequently occurring issues that impose a burden on taxpayers, require extensive factual development and where an understanding of industry practice and views would help IRS personnel in determining the proper tax treatment. Regardless of how the issue was identified, from a review of issued IDDs, the TEB Subcommittee has found that, in cases where an examiner can verify the tax treatment of an item through information reported by the taxpayer to an industry regulator, independent indices or verifiable certifications provided by the taxpayer or other parties, IDDs have implemented procedures that reduce the documentation the taxpayer needs to produce and the examiner needs to review.

For example, if a bank or insurance company has claimed a bad debt deduction under section 166 of the Internal Revenue Code of 1986, IDDs have directed examiners to accept the amount of the deduction without further inquiry if the taxpayer has claimed the amount it has reported to its industry regulator.[34] Similarly, where a marked-to-market valuation is involved in a case, IDDs call for examiners to respect the mark-to-market value reported by the taxpayer if it is the same value reported on financial

[30] LB&I Directive Providing Updated Guidance for Examiners on IRC Section 199 Benefits and Burdens of Ownership Analysis in Contract Manufacturing Arrangements.
[31] LB&I Updated Directive Regarding Examination of Milestone Payments in the Acquisition of Businesses (January 27, 2014); LB&I Directive Examination of Success-Based Fees in the Acquisition of Businesses (July 28, 2011).
[32] LB& I Directive Relating to Wireless Telecommunication Assets.
[33] LB& I Directives: (i) Regarding UTP [Unsettled Tax Positions] Guidance & Procedures for the Field (November 1, 2011); (ii) Regarding UTP Guidance and Procedures for the Compliance Assurance Process (CAP) Program (August 31, 2011); (iii) Field Guidance on the Planning and Examination of the Heavy Maintenance Visit (HMV) on Airframes; (iv) For Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties (July 15, 2011); (vi) On Examination Action with Respect to Certain Gain Recognition Agreements (July 26, 2010); (vi) On Planning and Examination of Cost Segregation Issues in the Biotech/Pharmaceutical Industry (November 28, 2005); (vii) Centralized Management of LB&I Returns with UTP Schedules (May 11, 2011); (v) Planning and Examination of Research Credit Issues in a Branded Pharmaceutical Company (April 4, 2004)' (viii) Examination Procedures for Sports Franchise Acquisitions (October 24, 2003); (xi) Field Guidance on the Planning and Examination of the Heavy Maintenance Visit (HMV) on Airframes (June 8, 2001).
[34] LB&I Directives: (i) Related to Section 166 Deductions For Eligible Debt and Eligible Securities (October 23, 2014) (Bank Bad Debt Deduction under Section 166); (ii) Related to Partial Worthlessness Deduction For Eligible Securities Reported by Insurance Companies – IRC Section 166 (July 30, 2012).

statements filed with a regulator.[35] Certain IDDs have also allowed examiners to rely on certifications made by the taxpayer or others. For example, an IDD issued in 2013 permits taxpayers who have contractual arrangements for manufacturing property to decide which has the benefits and burdens of ownership of the property for purposes of claiming the deduction allowed under Code section 199 for income derived from qualifying production property manufactured within the United States.[36] This permits the examiner to rely on the certifications of each party to the arrangement regarding which party is entitled to claim the deduction and eliminates the need to apply a facts and circumstances test [37] has the benefits and burdens of ownership for purposes of claiming the deduction, thus eliminating the need to apply a facts and circumstances test. In addition to addressing a single specific issue, IDDs also provide guidance for selecting and conducting audits of more extensive areas.[38]

Like examinations conducted by LB&I, examinations of tax-advantaged bonds can impose a significant burden in time and other resources both by issuers and borrowers (collectively "Issuers") and IRS examiners. The IRS audited an average of approximately 900 tax-advantaged bond issues for each of the last three years, and has announced a targeted approach to future audits and compliance checks. Often taxpayers may be asked in an initial information document request to produce extensive records. Reducing the taxpayer's need to produce records and the examiner's need to review them could save significant time and expense. The Subcommittee believes it would be helpful to both Issuers and TEB personnel to follow LB&I's approach and to utilize "TEB Director Directives" to streamline the examination process and other interactions between TEB and Issuers as discussed more fully in Section IV.B.3 below.

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[35] LB&I Directives: (i) IRC Section 475: Field Directive related to Mark-to-Market Valuation Frequently Asked Questions for IRC Section 475 (April 14, 2011); and (ii) For Hedging of Variable Annuity Guaranteed Minimum Benefits (GMxB) by Insurance Companies IRC Section 446 (July 17, 2014);

[36] LB&I Guidance for Examiners on IRC Section 199 Benefits and Burdens of Ownership Analysis in Contract Manufacturing Arrangements (July 24, 2013). Under Section 199, a deduction is also allowable for income derived from a qualified film or for electricity, natural gas or potable water produced in the United States.

[37] This approach may not be appropriate in instances where the parties have a shared interest in the tax treatment of a particular item.

[38] LB& I Directives: (i) Regarding UTP [Unsettled Tax Positions] Guidance & Procedures for the Field (November 1, 2011); (ii) Regarding UTP Guidance and Procedures for the Compliance Assurance Process (CAP) Program (August 31, 2011); (iii) Field Guidance on the Planning and Examination of the Heavy Maintenance Visit (HMV) on Airframes; (iv) For Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties (July 15, 2011); (vi) On Examination Action with Respect to Certain Gain Recognition Agreements (July 26, 2010); (vi) On Planning and Examination of Cost Segregation Issues in the Biotech/Pharmaceutical Industry (November 28, 2005); (vii) Centralized Management of LB&I Returns with UTP Schedules (May 11, 2011); (v) Planning and Examination of Research Credit Issues in a Branded Pharmaceutical Company (April 4, 2004)' (viii) Examination Procedures for Sports Franchise Acquisitions (October 24, 2003); (xi) Field Guidance on the Planning and Examination of the Heavy Maintenance Visit (HMV) on Airframes (June 8, 2001).

B. RECOMMENDATIONS FOR IMPROVEMENTS TO EFFICIENCY AND KNOWLEDGE MANAGEMENT FOR BETTER CUSTOMER SERVICE

1. Recommendations Made By the TEB Employee Development Team.

TEB has already identified employee development and knowledge managements as important tools in increasing efficiency and providing better service. TEB formed an Employee Development Team which was tasked with providing TEB management with recommendations regarding employee development and knowledge transfer. TEB employees provided feedback and made a series of suggestions to TEB management. This report includes our recommendations on these topics, which may be supplemental to, or in some cases, different from the recommendations of the Employee Development Team, but are based on our experience in working in the tax-exempt bond industry.

2. Improvements to Training and Cross-Training.

TEB has a long history of a robust training program. Budgetary constraints, however, have limited opportunities for in person training which is the most effective type of training. Similar training issues (and the cost issues associated with in person training) arise in private industry. In addition to some limited in person training, we recommend continued use of other training methods, including online training, increased use of written training materials and other types of training. For example, TEB should consider creating an online repository of training materials. Training materials prepared for any training session should be maintained as a part of this library. Similar materials from other industry sources, such as the American Bar Association Tax Section's Committee on Tax Exempt Financing and the National Association of Bond Lawyers, should be maintained and cross-referenced as appropriate. In addition; all seminars, focus groups, or other CPE sessions should be recorded and stored in this repository and indexed so that they are available to all TEB employees.

We are aware that TEB has had discussions with, or from time to time involved, private industry representatives in TEB training. Involvement of private industry representatives (attorneys, bankers and financial advisors, and issuers) in training efforts would be beneficial. Representatives from private industry can provide TEB personnel a level of awareness and perspective (for example, as to current market trends and conditions) that might not otherwise be available. In addition, private industry representatives may provide valuable materials for inclusion in the online repository, without burdening existing TEB employees with the task of preparing these materials.

We understand that cross-training, which can also be a valuable tool for many reasons, is also a topic which we understand is under consideration in TEB. Cross-training can energize employees by giving them new challenges; facilitate cross-pollination of ideas

and techniques from other specialties; and provide additional flexibility for dealing with employee promotions, transfers, departures, vacations and other absences. At the same time, however, it can lead to inefficiencies, inconsistencies in results to customers and some "re-inventing the wheel" types of issues. Even with these difficulties however, we support the concept of cross-training and recommend its adoption and implementation within TEB. The use of cross-training and its benefits needs to be balanced against the inherent issues associated with too much cross-training. Cross-training can be accomplished by rotating employees among different subject matter areas or job functions. However, due to the complexity of subject matter and the duration of cases and other issues, we recommend that rotation among areas not occur more often than every three years. We also acknowledge that cross-training opportunities may be limited or affected by applicable labor laws or collective bargaining agreements.

3. Development and Refinement of Additional Knowledge Management Tools.

Knowledge management is not a single tool or method, but rather an array of tools and methods of operation which make experience and information developed within an organization available to others in the organization in a way that improves efficiency and consistency of results.[39] Private industry has been focused on knowledge management for many years and has developed many tools or methods for making experience and information available within an organization. Use of knowledge management can greatly enhance the efficiency of an organization, reduce its training costs, enhance the consistency of results and limit the impact of inevitable changes in personnel. We are aware that development of knowledge management tools is a key focus of TEGE's strategic plan for 2015[40] and TEGE divisions including TEB have begun implementing and developing certain of these tools. The following additional tools or methods of operation (which may be duplicative of, or supplemental to, tools in development in TEB and TEGE generally) are ones that we would suggest for implementation or further development within TEB based on our experience in private industry:

(a) Create an online "experience database" of personnel in TEB beyond the existing group of subject matter experts (SMEs) who have experience in particular areas within TEB and can be contacted for subject matter expertise when required. For

[39] The Gartner Group, an information technology and research advisory firm, is credited with developing the following definition of knowledge management: "Knowledge management is a discipline that promotes an integrated approach to identifying, capturing, evaluating, retrieving, and sharing all of an enterprise's information assets. These assets may include databases, documents, policies, procedures, and previously un-captured expertise and experience in individual workers."

[40] Email dated Tuesday April 7, 2015 from Tammy Ripperda, Director of Exempt Organizations to Paul Streckfus, Editor, EO Tax Journal.

example, examiners who have conducted examinations on particular topics may be a valuable resource for other examiners without similar experience.

(b) Institute a regular practice of conference calls or video meetings within groups for discussion of current projects, initiatives and cases to gain insights and ensure consistency, especially among groups that focus on particular issues or industries. We believe that meetings or calls between SMEs and examiners to discuss current issues and focus group meetings should be frequent. [41] In private industry, it is not unusual for practice groups to hold calls, perhaps on a monthly or even weekly basis, for discussion of new or novel issues or developments. Where warranted, issues raised during these calls may lead to more involved focus group meetings or training.

(c) Create an internal "blog" or mail list for personnel to post questions or problems or seek additional help on issues. These blogs can provide timely answers to some questions, serve as a means of further identifying existing expertise, and serve as a means of identifying new or novel issues.

(d) Establish a database of types of issues or problems, organized around Code sections or topics (the organizational structure of tax materials prepared and maintained by the National Association of Bond Lawyers is a good example), including description of the issue, a brief description of the resolution, a list of the personnel involved and similar information.

4. Improvements to Examination Methods to Enhance Efficiency and Effectiveness.

The current process of selecting issues in various market segments for examination and then conducting the examination on a non-focused basis (often examining all potential issues raised by a transaction rather than focusing on particular problems) is highly inefficient, time-consuming and disruptive to the Issuer. An analogy might be giving a patient a general physical exam, including extensive blood work, x-rays, EKG and other tests because you are interested in determining whether the patient has periodontal disease. The current process, as seen from the Issuer's perspective, involves receiving a non-specific notice of examination, followed by a request to the Issuer for a copy of the closing transcript (which is often thousands of pages of documents) and other supplemental information (bank or trustee statements, investment records, copies of requisitions) which is very time consuming and expensive for the Issuer to compile. Although closing transcripts are now often available on a CD or in other electronic form,

[41] Our understanding is that TEB has already had one focus group meeting this year, and plans to have up to four in the current year.

other documents like trustee statements are not. As an alternative to requesting documents, TEB could conduct site audits where the benefits of the time and effort of making a site visit appear to be justified. In any event, even if the Issuer is not over-burdened by document requests because the documents are in electronic form, massive amounts of documents that may not really be pertinent to the purpose for the examination imposes an unnecessary burden on the agent to review. This is highly inefficient, time consuming and a waste of valuable TEB resources.

Furthermore, the information provided by issuers on the various versions of Form 8038 is quite limited and does not provide sufficient information to permit TEB to focus its examination efforts easily. Making revisions to the Form 8038 to improve the quality of information provided is a laudable goal, but itself is time consuming.[42] Even if revisions were made today, it would not help the many bond issues currently in the market which might need to be examined. For these reasons, we recommend that TEB consider using written compliance examination requests as a method for determining whether an issue should be selected for examination, and narrowing the scope of materials requested, which should lessen the burdens on Issuers, and reduce the time and effort of agents.

For example, if TEB wanted to examine issues relating to the purchase of open market escrow securities in refundings, it could select potential issues for examination by review of the Form 8038 filings which show whether the issue involves an advance refunding, but then further narrow the scope of the transactions selected for examination by sending a compliance examination letter inquiring whether the transaction involved a purchase of SLGs or open market securities. This would provide TEB with the ability to limit the transactions reviewed to those transactions that actually present the issue it wants to examine. Similarly, information document requests to the Issuer should be limited to documents that relate to the issue TEB wants to review, rather than immediately requesting a copy of the closing transcript and other voluminous information that is not really relevant to the proposed examination.

Admittedly, TEB may want to randomly conduct “general compliance” examinations which randomly select bond issues for examination of all relevant tax issues; however this type of examination is very expensive and burdensome to the Issuer and to TEB, and should be done on a limited basis, as opposed to the more focused type of examination. [43]

[42] We understand that changes to the Form 8038 have been proposed, but that the approvals involved in implementing these changes may take several years.

[43] General compliance examinations are inherently difficult because, to be effective, they must involve either an agent with expertise across a number of specialized areas, or a team of agents with the relevant expertise. While as noted in other areas of this report, cross-training and knowledge management may

"TEB Directives" modeled after LB&I's IDD's could be utilized to direct TEB personnel how to select an issue for audit and how to proceed with the conduct of an audit or how to resolve a specific issue presented in a particular case. As discussed in Section IV.A.2 above, IDDs issued by LB&I generally address issues that are complex and require significant resources on the part of both the IRS and the taxpayer. The directives adopt solutions that streamline the audit process without requiring the IRS to sacrifice substantial revenue collection and allow use of information that is readily available and can be verified without requiring production by the taxpayer of additional documentation or information. LB&I directives also prescribe an approach to conducting examinations that can be gathered and verified without collecting additional paperwork.

Rebate audits are an example of the type of cases in which "TEB Director Directives" ("TDDs") could be used to reduce the burden on and free resources of both TEB Taxpayers and TEB personnel. A rebate TDD could identify bonds that should not be audited. For example, between 2010 and 2014 interest rates have been at record lows and it is highly unlikely that bonds issued during this period earned any arbitrage. Since such bonds are unlikely to have any rebate due, the TDD could instruct examiners not to audit such issues thus freeing resources to be applied to areas where non-compliance is more likely.

For an issue selected for a rebate examination, the TDD could outline the planning and conduct of the examination in ways to minimize time and resources for both the Issuer and examiner. For example, if a rebate report has been prepared by an independent third party, the examiner may be able to rely on the rebate report since rebate reports include calculation of yield on the bonds, yield on investments, market values of investments, timing of deposits and disbursements, opinions whether spending exceptions have been met, analysis of transferred proceeds if applicable and calculation of any rebate due or potentially due. Examination of the rebate report together with the other documents initially requested could be sufficient to allow the examiner to complete the audit. If necessary, the Issuer or other appropriate party, such as a bond trustee, could be asked to certify that the information regarding deposits and disbursements reflected in the rebate report is accurate. Valuation of investments not subject to bidding can be confirmed by market comparisons, if necessary (or if not capable of valuation by market comparison, by certification of the bond trustee or other independent party).[44] If the examiner can conclude the audit without requesting and reviewing additional copies

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ameliorate this issue, scarcity of resources and desire for uniformity of results may argue for limiting the number of general compliance examinations.

[44] The directives relating to mark to market value discussed above and cited in footnote 26, above, rely on values as reported to regulators. These directives note that the investments discussed in those directives are not generally capable of valuation in the market. Thus, confirmation by a market comparison should be sufficient where the investments are capable of valuation in this manner.

of agreements and copies of bank statements, both TEB and issuers or TEB taxpayers will be able to conserve time and expense.

A sample TDD for the planning and conduct of a rebate audit with additional detail is attached as Appendix A.

Rebate is only one example of an area where administrative action through TDDs may be helpful in streamlining a process. Information may be available from sources other than document production after information document requests are issued. Forms 990 are an example; there may also be information provided through primary or secondary mandatory or voluntarily disclosure. The Subcommittee suggests that TEB consider such other possible sources of information as part of the process of selecting bonds for audit or conducting an audit. Similarly, if an audit of a particular bond issue has been concluded – private use issues, for example – and a subsequent examination of the same bonds includes this issue, the TEB taxpayer should be able to make certifications, with verification if necessary, that there has been no change in contracts or increase in use in order to reduce the production and review of documents.

V. CONCLUSION

The market for tax-exempt bonds has evolved and changed – transactions are more complex, present new and novel issues and continue to evolve to changes in the market and the needs of the issuers. At the same time, the resources available to the IRS and TEB to provide additional guidance and conduct examinations to ensure compliance have been diminished. TEB in particular has suffered reduced head count and reductions in budget (which limit the number of personnel) have limited its ability to provide the most effective training to agents and other personnel, and generally to keep up with the demands of the market.

These changes require continued and further evolution by TEB to meet the demands imposed by the market, and by the special relationship between the federal government and state and local entities, in a time of reduced resources. TEB has already initiated some knowledge management measures and expects to continue to develop tools to assist in “doing less with more.” Other IRS divisions have adopted approaches, such as the IIR and IDD programs discussed in this report, which may provide TEB with new ways to meet increased demands. As with all such programs, the particular circumstances involved in tax-exempt bonds may require some modification to tailor them to TEB’s operations, but this type of experimentation will be essential to meeting the goals of providing improved tax compliance in times of increasing market complexity and reduced resources.

In addition to borrowing ideas like the IIR and IDD programs which have been implemented in other areas of the IRS, TEB should continue to look outside of the IRS to initiatives adopted in the private sector, such as various knowledge management techniques described in this report, which may improve efficiency, provide better information to agents and other TEB personnel and improve consistency of results to issuers. Similarly, adopting cross-training and improving training methods may provide increased efficiency and flexibility to TEB, although these tools need to be balanced against the risk of their creating undue burdens on issuers or inconsistent results if not properly balanced.

Finally this report recommends that enforcement and examination techniques continue to evolve to reduce the burdens on Issuers and TEB personnel. Written compliance checks and thoughtful use of IDR's, other document requests and TDD's (IDD's adapted for use by TEB) can avoid undue burdens on issuers, and reduce wasteful use of TEB resources in reviewing materials that are not likely to increase tax compliance in a meaningful way.

APPENDIX A

Field Guidance on the Planning and Examination of Rebate Issues For Tax-Advantaged Bonds

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

WASHINGTON, D.C. 20224

Tax Exempt Bonds

Governmental Entities Division

[Date]

MEMORANDUM FOR TEB PERSONNEL

FROM: Director, Tax Exempt Bonds

SUBJECT

Planning and Examination of Rebate Issues for Tax-Advantaged Bonds

The purpose of this memo is to provide guidance to examiners in selecting and auditing rebate issues. This is not intended to be a technical position but to provide audit issue direction to insure the effective use of resources.

<u>Planning</u>

1. At the beginning of an examination, the examiner should review the Form 8038 for the bond issue and Form 990 of the borrower, if applicable, and determine whether the issue:

    a. Is a new money, refunding, or combination issue,
    b. Is fixed or variable rate,
    c. Has a qualified hedge and whether it is integrated,
    d. Has unspent proceeds, or

e. Has transferred proceeds.

The examiner should then contact by telephone or other means a representative of the issuer to obtain any preliminary information not available from the Form 8038 or 990, as the case may, and to determine whether rebate report(s) have been prepared for the issuer by a qualified provider independent of the issuer (Rebate Report).

2. If there is a Rebate Report, request a copy of:

   a. The Rebate Report;
   b. The Arbitrage Certificate with the issue price certificate and any relevant certificates, and copies of bidding records, if applicable, and,
   c. A copy of the escrow agreement in the case of an advance refunding.

   If there is no Rebate Report prepared by an independent party, the examiner should continue with the examination unless the circumstances do not warrant further development of the examination. For example, for transactions involving current refundings, or construction funds (other than those transactions which also include an advance refunding or bond-funded reserve funds) during the 2010 to 2014 time period are very unlikely to present arbitrage issues and do no warrant further review except in unusual circumstances.

3. Review the following:

   a. Rebate Report
   b. Arbitrage Certificate and other documents and information provided for determination of yield on the bonds, yield on the investments, timing of deposits and disbursements, valuations of investments,
   c. Opinions in the Rebate Report regarding satisfaction of applicable exceptions to rebate and yield restriction, analysis of transferred proceeds if applicable, and
   d. Calculation of any rebate due or estimated to be due. Valuations of investments can be confirmed by market comparison or certification of the bond trustee or paying agent.

4. If the examiner is satisfied that the rebate report is accurate, the examiner can conclude the examination at this point. If the examiner is not satisfied that the report is correct, or, as indicated above, there is no independent rebate report, the examiner should continue with the examination where warranted.

Continuation of Examination

5. The Examiner should ask the issuer whether it is intending to rely on a specific exemption or exemptions from rebate such as the Small Issuer Exemption to rebate under Section 148 (f) (2) of the Code or other factors that may permit a more limited document production and review. The Examiner should initially request copies of documents that establish any necessary basis for the exemption, including the Bond Transcript (with the Arbitrage Certificate), copies of investment agreements, swap agreements, bank statements and bidding records to the extent the information to be gleaned from these documents is not available from the Form 8038 or 990, if applicable.

6. Review initially requested documents and proceed with the conduct of the examination.

7. Examiners should refrain from requesting documents or submitting broad information document requests which request information unrelated to the particular questions under examination.