NATIONAL TAXPAYER ADVOCATE

SPECIAL REPORT TO CONGRESS

Political Activity and the Rights of Applicants for Tax-Exempt Status

TAXPAYER ADVOCATE SERVICE

YOUR VOICE AT THE IRS

www.TaxpayerAdvocate.irs.gov/2014ObjectivesReport

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Table of Contents

PREFACE v

EXECUTIVE SUMMARY 1

LEGAL BACKGROUND 7

The IRS is required to disallow applications for exemption under IRC § 501(c)(3) if the applicant will participate in political campaigns and under (c)(4) if the applicant's primary purpose is political.. 7

Political organizations that primarily engage in political activities are eligible for tax exemption under IRC § 527, but unlike IRC § 501(c)(3) and (c)(4) organizations, they are required to disclose donors to the public. 8

The IRS must apply a facts-and-circumstances test to identify political activity based on the applicant's planned activity.. 8

PROCEDURAL BACKGROUND 11

IRS screeners used check sheets to identify cases requiring further review.. 11

Tea Party applications for tax exemption were screened into a category that received further review as "potential political" organizations. 11

DISCUSSION AND PRELIMINARY RECOMMENDATIONS 14

A. Lack of Guidance and Transparency 14

It is difficult to determine whether an organization violates the limits on political campaign activity because the limits are not clearly defined. 14

Recommendation: Clarify the level of political activity that exempt organizations may conduct, and establish an objective test to identify when an organization exceeds that level.. 15

Guidance has not developed, in part, because there is no judicial review of applications for exemption under IRC § 501(c)(4).. 15

Recommendation: Consider legislation to provide applicants for exemption under IRC § 501(c)(4) with the ability to seek a declaratory judgment if denied or unanswered after nine months so that more judicial guidance can develop. 16

The IRS, a tax agency, is assigned to make an inherently controversial determination about political activity that another agency may be more qualified to make.. 16

Recommendation: Explore the feasibility of requiring the FEC or another specialized agency to certify to the IRS that political activity proposed by an applicant for exemption under IRC § 501(c)(4) is not excessive.. 17

The form used by applicants for exemption does not make it easy for the IRS to identify excessive political activity. 17

Recommendation: Consider revising the IRC § 501(c)(4) application (Form 1024) to make further review unnecessary in most cases. 17

It is difficult to assess an applicant's level of political activity before operations have commenced.. 18

Recommendation: Gather data from random audits and thereby develop a risk model to deploy in compliance reviews of organizations after operations have commenced.. 18

EO's failure to post its procedures to the Internet appeared to violate the law and contributed to the problem.. 18

Recommendation: Publish on the Internet objective criteria that may trigger additional review of applications for exemption and the procedures IRS specialists use to process applications involving political campaign activity. 20

EO's failure to clear its procedures with TAS and other stakeholders bypassed an important safeguard of taxpayer rights. 21

Recommendation: The IRS Commissioner should require all IRS functions to clear all guidance and procedures that affect taxpayer rights in any way with TAS and incorporate it into the public IRM (or clear it with internal stakeholders, including TAS, and then post it to the Internet in the same manner as the IRM). 22

B. Absence of Adequate Checks and Balances 22

EO violated the principles underlying a number of fundamental taxpayer rights.. 22

Recommendation: Implement the National Taxpayer Advocate's recommendation to create a Taxpayer Bill of Rights. 23

Applicants for exemption (and others) have no remedy for the violation of their rights. 23

Recommendation: Authorize the National Taxpayer Advocate to make an "apology" payment of up to $1,000 to a taxpayer where the action or inaction of the IRS caused excessive expense or undue burden, and the taxpayer experienced a "significant hardship." 24

Congress no longer holds joint annual oversight hearings to review IRS challenges. 24

Recommendation: Reinstate the annual joint oversight hearings held after RRA 98 to help identify and address problem areas, with specific focus on how the IRS is meeting the needs of particular taxpayer segments, including individuals, small businesses, and exempt organizations.. 24

C. Management and Administrative Failures 25

Management failed to install an adequate inventory management system. 25

Recommendation: EO should track the age and cycle time of all of its cases, including those referred to EO Technical, so that it can detect backlogs early in the process and conduct periodic reviews of over-aged cases to identify the cause of the delays.. 26

Management failed to ensure requests for guidance received a timely response. 26

Recommendation: EO should track requests for guidance or assistance from the EO Technical Unit so that management can assess the timeliness and quality of the guidance and assistance it provides to both Determinations Unit employees and the public. 26

Management failed to mitigate the burden resulting from its automated exemption revocation process, multiplying exempt organization applications and straining EO resources. 27

Recommendation: The IRS should create an administrative appeal process for organizations whose exempt status was automatically revoked in error. 27

D. EO's Cultural Difficulty with TAS 28

EO executives resisted TAS's authority to order expedited processing of applications and isolated EO from TAS. 28

Recommendation: The National Taxpayer Advocate should provide training to EO employees about her authority under IRC § 7811 to order expedited processing of applications for exempt status and advocate for taxpayers. 28

TE/GE employees did not refer cases to TAS when appropriate, as required.. 29

Recommendation: TAS and the National Taxpayer Advocate should provide guidance and training to EO employees about when to refer cases to TAS.. 30

EO's failure to refer IRC § 501(c)(4) cases eligible for TAS assistance or report a systemic problem undermined TAS's ability to identify a continuing systemic problem. . . 30

Recommendation: TAS and the National Taxpayer Advocate should provide guidance and training to EO employees about when to refer systemic issues to TAS. 31

E. Update: TAS and TE/GE are now working together to address EO management issues and reduce taxpayer burden. 34

CONCLUSION 36

I. Preface

Honorable Members of Congress:

The Internal Revenue Code requires the National Taxpayer Advocate to submit two annual reports to the House Committee on Ways and Means and the Senate Committee on Finance.[1] The National Taxpayer Advocate is required to submit these reports directly to the Committees without any prior review or comment from the Commissioner of Internal Revenue, the Secretary of the Treasury, or the Office of Management and Budget.[2] The first report, due by June 30 of each year, must identify the objectives of the Office of the Taxpayer Advocate for the fiscal year beginning in that calendar year.[3]

The Taxpayer Bill of Rights: A Framework for Effective Tax Administration

Over the last few months, the Internal Revenue Service has been the center of public attention for several reasons, most notably its scrutiny of politically active social welfare organizations seeking recognition as tax-exempt entities. The public attention to these recent events has in many ways reinforced many taxpayers' preconceived perceptions of the IRS as an agency that treats taxpayers unfairly. While all this is grievous enough and in fact calamitous for public respect for and compliance with the tax laws (because once lost, trust takes a very long time to be regained), these events are symptoms of broader problems festering at the IRS.

There is much that is good about the IRS – indeed, I have the deepest respect for the agency and its workforce, even when I vigorously disagree with the IRS's actions or policies. But today, the IRS is an institution in crisis. In my view, however, the real crisis is not the one generating headlines. The real crisis facing the IRS – and therefore taxpayers – is a radically transformed mission coupled with inadequate funding to accomplish that mission.[4] As a consequence of this crisis, the IRS gives limited consideration to taxpayer rights or fundamental tax administration principles as it struggles to get its job done.

I've written elsewhere about the behavior this inadequate funding drives in the IRS – namely, a widget-based approach to tax administration, getting work done in a way that allows as little interference as possible to the employees charged with doing the work.[5] Interference is viewed as any number of things – interactions with taxpayers, intervention by the Taxpayer Advocate Service (TAS), even proposed process improvements that require

1 Internal Revenue Code (IRC) § 7803(c)(2)(B).

2 IRC § 7803(c)(2)(B)(iii).

3 IRC § 7803(c)(2)(B)(i).

4 National Taxpayer Advocate 2010 Annual Report to Congress 15 (Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*).

5 Nina E. Olson, *A Brave New World: The Taxpayer Experience in a Post-Sequester IRS (the Laurence Neal Woodworth Memorial Lecture)*, Tax Notes Today 106-118 (June 3, 2013).

learning new steps or approaches. Anything that can be automated to eliminate taxpayer interaction and move work along will be automated. The result is a tax system that gives short shrift to the legitimate needs of taxpayers and their specific circumstances.

A tendency toward dehumanization arises in any large bureaucracy and requires constant monitoring and action to keep it in check so the organization retains its human touch. In the tax world, the greatest tools we have to guard against dehumanization are the principles enunciated in a Taxpayer Bill of Rights (TBOR).[6] It may be tempting to dismiss a TBOR as some sort of gimmick, but a TBOR is no more a marketing device than is our constitutional Bill of Rights. In a 2012 survey commissioned by my office, only 46 percent of U.S. taxpayers said they believed they have rights before the IRS, and only 11 percent said they knew what those rights were.[7] While Congress has enacted three pieces of legislation called TBORs, each containing specific rights and remedies, these acts are not statements of broad, overarching principles similar to our constitutional Bill of Rights. How will taxpayers (including IRS employees) avail themselves of their statutory rights if they don't know they have rights or what their rights are?[8]

For this reason, I have repeatedly recommended that Congress enact a Taxpayer Bill of Rights that takes the dozens of existing taxpayer rights embedded in the Internal Revenue Code and groups them into ten broad categories, modeled on the U.S. Constitution's Bill of Rights. These "rights," in substance, would be labels designed to make existing rights clearer and more accessible to taxpayers and IRS employees alike.

The 10 categories of "rights" I have recommended are as follows:

1. The right to be informed.
2. The right to be assisted.
3. The right to be heard.
4. The right to pay no more than the correct amount of tax.
5. The right of appeal.
6. The right to certainty.
7. The right to privacy.
8. The right to confidentiality.
9. The right to representation.

6 For a detailed discussion of my legislative recommendation for a taxpayer bill of rights, see National Taxpayer Advocate 2011 Annual Report to Congress (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*) 493-518; and National Taxpayer Advocate 2007 Annual Report to Congress (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*) 478-489. *See also* National Taxpayer Advocate Blog, *Why We Need a Taxpayer Bill of Rights* (Feb. 15, 2012), *at* http://www.taxpayeradvocate.irs.gov/Blog/why-we-need-a-taxpayer-bill-of-rights.

7 Forrester Research, Inc., *The TAS Omnibus Analysis*, from North American Technographics Omnibus Mail Survey, Q2/Q3 2012, 19-20 (Sept. 17, 2012).

8 *See* Area of Focus: *TAS Works to Ensure Taxpayers Know Their Rights and Obligations*, vol. 1, *infra*.

10. The right to a fair and just tax system.

A TBOR would act simultaneously as an organizing principle for tax administrators, an educational framework for IRS employees, and a consciousness-raising document for taxpayers. It would provide a significant check and balance against government overreaching. Moreover, a foundational taxpayer bill of rights would more clearly expose the gaps in our statutory or administrative construct (*i.e.*, where we lack remedies for violations of our rights).

IRS Actions and Inaction with Respect to 501(c)(4) Organizations Violated Eight Out of Ten Taxpayer Rights

As we discuss in our *Special Report* accompanying this Report to Congress, if the IRS Exempt Organizations (EO) function had operated in accordance with the TBOR I've proposed over the years, it would have had procedures in place to provide protections against the management and other failures Treasury Inspector General for Tax Administration (TIGTA) identified as harming taxpayers.

As we describe in our *Special Report,* the IRS first and foremost violated these taxpayers' *right to be informed.*[9] The IRS did not provide adequate or timely guidance to (c)(3) or (c)(4) taxpayers about the acceptable level of political activity (and it did not adequately train or provide guidance to its employees so they could assist these taxpayers), nor did the IRS make public its instructions to staff, its checklists, and its guidance memoranda as the Freedom of Information Act (FOIA) and e-FOIA require. Moreover, the IRS did not explain to taxpayers why their applications were delayed.

The IRS did not handle these applications with any semblance of timeliness – in fact, TIGTA reports there was a period of 13 months in which no action at all was taken on any of the impacted cases while employees in the IRS's EO Division waited for additional guidance. When taxpayers (and TAS) raised objections, their concerns were met with stock, template responses, and during the periods of delay, taxpayers were not told what additional information they should be gathering to dislodge their cases. Thus, the IRS violated the taxpayers' right to be assisted[10] and right to be heard.[11]

As we note in our *Special Report,* IRC § 501(c)(4) taxpayers do not have the same right to judicial review as § 501(c)(3) taxpayers, who may petition the United States Tax Court for a declaratory judgment where the IRS has not ruled within 270 days or has issued a denial of

9 Taxpayers have the right to know what is expected of them in terms of complying with the tax law. Taxpayers also have the right to have access to IRS procedures, policies, guidance, and other instructions to staff to the extent permitted by law. They have the right to a clear explanation of the law and IRS procedures, and they have the right to be informed of the results of, and reasons for, IRS decisions about their tax matters.

10 Taxpayers have the right to receive prompt, courteous, and professional assistance about tax obligations in the manner in which they are best able to understand it, and to be provided a method to lodge grievances when service is inadequate. They have the right to expect that the tax system will attempt to keep taxpayer compliance costs to a minimum, and that assistance will be available in a timely and accessible manner and without unreasonable delays.

11 Taxpayers have the right to raise their objections and provide additional documentation or an explanation in response to actions by the IRS, which shall consider those objections and explanations promptly and impartially. The IRS shall provide taxpayers with an explanation of why their objections or explanations are not sufficient and what is required to better document their concerns, where appropriate.

tax-exempt status.[12] This fundamental right to an appeal[13] not only would provide the taxpayer with meaningful recourse and impartial oversight of IRS decisions, but it also would help develop case law and additional guidance in a complex area of law. Instead, taxpayers' applications languished for months and even years, violating their right to certainty.[14]

These taxpayers' *right to privacy*[15] was violated when the IRS burdened them with unnecessary questions, including document or other requests where the IRS itself could just as easily have secured the information (*e.g.*, from websites) and provided that information to the taxpayer for explanation if it raised concerns. The *right to confidentiality*[16] was violated by the request for donor information that would otherwise be non-public were it provided in the annual Form 990 filing. And finally, *the right to a fair and just tax system*[17] was demonstrably violated by EO's failure to design the application process so that it obtained more detailed and consistent information about political activities in an impartial manner from all applicants engaging in that activity, via a better-designed application form. This failure gave rise to the appearance of partisan action by the IRS. This right was also violated by EO's comprehensive failure to refer these cases to the Taxpayer Advocate Service, all of which appeared to qualify for our assistance, thereby undermining an important "early warning system" and circumventing the designated guardian of taxpayer rights in the IRS.[18]

If the IRS had conducted the above analysis on each and every one of its compliance, enforcement, and taxpayer service initiatives, we would not be facing the crisis we are today. Not only would programs and initiatives be better designed in conformity with fundamental tax administration principles, but this analysis would force the IRS to articulate what level of funding and resources it needs to administer the tax system so as to avoid violations of taxpayer rights. Such an analysis would put a spotlight on the serious consequences of the IRS's declining budget.

12 IRC § 7428.

13 Administrative and judicial appeals are crucial to the actual and perceived fairness of the tax system from the taxpayer perspective. Taxpayers have the right to be advised of and obtain a prompt administrative or judicial appeal that provides an impartial review of all compliance actions or administrative determinations (unless expressly barred by statute) and an explanation of the rationale for the decision.

14 Taxpayers have the right to know the tax implications of their actions and the date and circumstances under which certain actions are final.

15 Taxpayers have the right to expect that any IRS inquiry or enforcement action will involve as little intrusion into their lives as possible, will be limited to information relevant to the matter at hand, and will respect all due process protections, including search and seizure protections and the provision of a collection due process hearing, where provided by law.

16 Taxpayers have the right to expect that any information provided to the IRS will not be used or disclosed by the IRS unless authorized by the taxpayer or other provision of law.

17 Taxpayers have the right to expect that the tax system will take into consideration, impartially and humanely, the specific facts and circumstances that might affect their underlying liability, ability to pay, or ability to provide information timely. Taxpayers have the right to have access to the Office of the Taxpayer Advocate for assistance. They also have the right to compensation or damages where the IRS has excessively erred, delayed, or taken unreasonable positions.

18 There are two additional taxpayer rights that are not directly implicated in the EO matter: *the right to pay the correct amount of tax due* and *the right to representation.*

Our Report Identifies Areas of Critical Risk for Taxpayers and the IRS

This year, as I've mentioned, we have taken the unusual step of issuing a supplement to the National Taxpayer Advocate's Objectives Report to Congress. In the *National Taxpayer Advocate Special Report to Congress: Political Activity and the Rights of Applicants for Tax-Exempt Status*, we discuss the significant challenges the IRS faces when determining whether political activity by EOs is at permissible levels. We suggest a framework for making these determinations that incorporates appropriate checks and balances. We also offer our analysis of some of the root causes of the problems experienced by the taxpayers identified in the TIGTA report and discuss TAS's efforts on behalf of taxpayers who sought our assistance. Based on this analysis, we make administrative recommendations that we believe will improve IRS management of its inventory and ensure that taxpayers experiencing undue burden and delays, or economic harm, are properly referred to TAS for help. We also have identified improvements we plan to make to TAS's own training and procedures so our employees are better able to advocate on behalf of these taxpayers.

A brief perusal of the Areas of Focus and Filing Season discussion in Volume 1 of this report shows that the IRS is struggling and thereby unduly burdening taxpayers in areas of taxpayer administration as diverse as the following:

- Making whole the victims of tax return preparer fraud;[19]
- Conducting adequate oversight of the tax return preparer industry;[20]
- Providing effective, timely, and taxpayer-centric relief to victims of identity theft;[21]
- Utilizing effective and timely collection alternatives to minimize taxpayer burden while reducing the number and dollar amount of balance-due accounts;[22]
- Conducting education and outreach to taxpayers about their responsibilities under the Affordable Care Act;[23]
- Resolving erroneous revocations of the tax-exempt status of small § 501(c)(3) organizations and failing to provide a pre-revocation administrative appeal;[24]
- Establishing confusing and draconian "settlement initiatives" for the millions of taxpayers who have legitimate reasons for overseas bank and financial accounts and whose failure to file reports was merely negligent;[25]
- Addressing the needs of international taxpayers;[26]

19 *See The IRS Harms Taxpayers by Refusing to Issue Refunds to Some Victims of Return Preparer Fraud*, vol. 1, *infra*.

20 *See The Current Limited Oversight of Return Preparers Makes Taxpayers Vulnerable to Unscrupulous or Incompetent Preparers,* vol. 1, *infra*.

21 *See As the IRS Adopts a Specialized Approach to Identity Theft Victim Assistance, Concerns About Complete and Timely Account Resolution Remain,* vol. 1, *infra*.

22 *See Collection Update: The IRS's Tepid Approach to Implementing Recent Changes in Collection Policies Has Limited Taxpayer Access to Important Collection Options*, vol. 1, *infra*.

23 *See TAS Prepares for Implementation of Health Care Provisions*, vol. 1, *infra*.

24 *See The IRS has Revoked the Exempt Status of Thousands of Organizations in Error, Causing Significant Harm to Taxpayers,* vol. 1 *infra.*

25 *See IRS Offshore Voluntary Disclosure Programs Continue to Burden "Benign Actors" and Damage IRS Credibility,* vol. 1, *infra*.

26 *See International Taxpayer Service Initiatives Continue but Need a More Formal Structure*, vol. 1, *infra*.

- Failing to provide adequate service and causing real harm to applicants for Individual Taxpayer Identification Numbers (ITINs) who must relinquish their original identity documents for months at a time (think about doing that yourself and see how your throat constricts in this post-9/11 world!);[27] and
- Substantially degrading the IRS Tax Forums as a means to communicate with a large number of tax practitioners, especially currently unregulated ones.[28]

Two of the above Areas of Focus deserve specific mention here, because of the severity of taxpayer rights violations involved.

Erroneous Revocations of Tax-Exempt Status Burden Taxpayers, Create Re-work for the IRS, and Violate Taxpayer Rights

In Volume 1 of this report, we highlight an issue involving exempt organizations that has received scant public attention. The IRS's implementation of the statutory requirement for automatic revocation of small exempt organizations that have not filed an e-postcard return for three consecutive years has been understaffed, inflexible, and taxpayer adverse.[29] Think Little Leagues and PTAs. Despite our repeated discussions with past EO leadership and our recommendations in past Annual Reports to Congress, the IRS has failed to provide these taxpayers with even minimal due process protections such as administrative review of proposed revocations, thereby violating the taxpayers' *right to an administrative appeal*. The IRS has declined to act upon our recommendation that it create a separate, simpler Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, for use by these small organizations so we can quickly reinstate their exempt status and they can continue to serve the public good. Moreover, the IRS has ignored our repeated warnings that it was seriously understaffed to handle the influx of EO applications.[30] The IRS has erroneously revoked the exempt status of thousands of EOs and has a significant backlog of IRC § 501(c)(3) applications, burdening both new and revoked EOs alike. This state of affairs violates taxpayers' rights to be assisted, to certainty, and to a fair and just tax system.

IRS's Continuing Failure to Provide Relief to Victims of Return Preparer Fraud Violates Fundamental Concepts of Fairness and Due Process

In my 2012 Annual Report to Congress, I identified as a most serious problem for taxpayers the IRS's failure to provide timely relief to taxpayers who are defrauded by their tax return preparers. This situation arises when a preparer alters the taxpayer's return, without the taxpayer's knowledge, by either inflating the taxpayer's refund or redirecting that refund to

27 *See IRS ITIN Policy Changes Make Return Filing Difficult and Frustrating*, vol. 1, *infra*.

28 *See Cuts to IRS Tax Forums Mean Lost Opportunities*, vol. 1, *infra*.

29 Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (Aug. 17, 2006).

30 In its response to our 2007 Most Serious Problem, in which we noted that understaffing plays a major role in 501(c)(3) exemption application processing delays, the IRS formally responded, "The IRS sees no evidence on which the National Taxpayer Advocate could conclude that the backlog will swell again once we have eliminated it." We note that the IRS never eliminated its backlog. See National Taxpayer Advocate 2007 Annual Report to Congress 210, 217 (IRS Response, Most Serious Problem: *Determination Letter Process*).

an account controlled by the preparer, or both. IRS Chief Counsel has opined since 2003 that the IRS has the authority to issue the taxpayer his or her correct refund, yet as of today, the IRS has not established procedures for making these taxpayers whole. Instead, it has directed its employees to put these cases on hold indefinitely until someone, somewhere, makes a policy call.

In fiscal year (FY) 2012, TAS received 439 cases involving this issue and for FY 2013 (through May 31) we have received 260 cases. During the first seven months of FY 2013, TAS has issued 77 Taxpayer Assistance Orders (TAOs) concerning this issue, compared with 58 for the entire 2012 fiscal year. I personally have issued 21 TAOs to the former Acting Commissioner of Internal Revenue or the Commissioner of the IRS's Wage & Investment Division, and I have already issued four to the Principal Deputy Commissioner.[31] More than 40 TAOs have been appealed by the Operating Divisions, and I will soon elevate them to the Principal Deputy Commissioner as well.

The IRS delay and failure to act with any degree of urgency with respect to these taxpayers is egregious. The average refund sought in the 21 cases I elevated to the former Acting Commissioner or the Commissioner of the Wage & Investment Division is $2,901, and the average age of these cases is 540 days. These taxpayers are generally low income and do not have the wherewithal to raise their concerns to Members of Congress. Yet the harm to them is at least as great as that visited upon the 501(c)(4) organizations because some of these low income taxpayers need their refunds to pay for basic necessities. The IRS's inaction violates these taxpayers' *rights to be assisted, to be heard, to pay the correct amount of tax due, and, most importantly, to a fair and just tax system.* There is no justification and no excuse for this callous treatment of taxpayers. Immediately prior to this report going to press, I briefed the Principal Deputy Commissioner about this issue, and I look forward to working with him to bring resolution and relief these taxpayers as soon as possible.

Insufficient IRS funding has led to restrictive training policies that leave IRS employees inadequately trained and unwilling or unable to identify and address both routine and novel taxpayer problems

In our 2011 and 2012 Annual Reports to Congress, we identified the inadequate funding of the IRS as the number 1 and number 3 most serious problems of taxpayers, respectively.[32] In my recent Woodworth lecture, I laid out the consequences of this inadequate funding combined with inadequate education about and protection of taxpayer rights. If a tax agency both collects more than 90 percent of federal revenues – $2.52 trillion in FY 2012 – and administers the second largest federal antipoverty program (the Earned Income Tax Credit)

31 IRC § 7811. TAS can issue a Taxpayer Assistance Order (TAO) to order the IRS to take certain actions, cease certain actions, or refrain from taking certain actions (*e.g.*, to release a levy). TAS may also issue a TAO to order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case, or review the case at a higher level. Once TAS issues a TAO, the IRS can comply with the action ordered or appeal the issue for resolution at a higher level.

32 National Taxpayer Advocate 2011 Annual Report to Congress 3 (Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*); National Taxpayer Advocate 2012 Annual Report to Congress 34 (Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*).

as well as retirement, education, and health care policies in addition to all sorts of business incentives, and then there is an eight percent budget cut over three years, including an 83 percent training budget decrease – well, to put it mildly, bad things will happen to taxpayers. The IRS will cut corners, eliminate protections it doesn't understand and deems unnecessary, make decisions in ignorance of the law, and generally not spend the time necessary to understand specific taxpayer concerns until things reach a crisis level.

The point about education and training is particularly important in light of the recent TIGTA audit, highlighting frivolous, wasteful, and even improper activities by one IRS function.[33] I fear this report will be used to justify what I view as dangerous cuts to the IRS training and training-related travel budgets.

In 2010, as we did in each prior year since 2003, the Taxpayer Advocate Service conducted an all-employee Technical Symposium. I proposed this approach to training because I believe there are significant, practical benefits to delivering certain training and education in a face-to-face setting so TAS employees can learn from their peers in other offices and so that all employees can hear the same message and have the opportunity to question their leadership in person. TAS developed a curriculum designed to build general expertise in all areas of eight employee tracks as well as specific expertise in certain areas. We designed, developed, and delivered 79 courses (219 sessions) in eight occupational tracks – including case and intake advocates, analysts, technical advisors, managers, and support staff – using TAS employees of all grade levels as subject matter experts and instructors. In addition to some larger sessions, each employee followed a curriculum that included four mandatory courses within his or her job track, four elective courses within that job track, and four true electives, enabling employees to stretch and pursue and develop their professional interests and careers. I personally taught several technical courses, conducted about ten town hall meetings, and met almost every employee who attended. In 2010, we negotiated a below-per diem hotel rate, and by being in Philadelphia, employees in IRS offices on the Amtrak line were able to return home on Thursday night, thereby saving taxpayers the cost of additional hotel nights.

The per capita cost for this training was $1,470. It was an effective and efficient way to train TAS employees, gain a shared vision for the organization, and learn and share ideas with co-workers from other regions and offices. It enabled me and the rest of the TAS executive leadership to observe where our employees misunderstood or resisted policies and practices, and to identify where they needed additional training or clearer explanations of our decisions. We learned which procedures required revision to relieve employee or taxpayer burden.

I would hold this Technical Symposium again in a heartbeat if funding were available.

33 Treasury Inspector General for Tax Administration (TIGTA Ref. No. 2013-10-037, *Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California* (May 13, 2013).

Sadly, we are moving in the opposite direction. Today, as the executive over a 1,900 person organization, I cannot approve training or training-related travel in an amount over $2,999.[34] The Commissioner cannot approve travel over $24,999. Anything above that amount must be approved by the Department of the Treasury. In my own organization, these procedures have resulted in newly hired case advocates not receiving necessary and required training for over 18 months, and we have just learned that it will be delayed yet again. Because TAS deems it necessary for this training to be delivered in a face-to-face environment in order to foster animated discussion, role-playing, problem-solving, and use of the case-study technique, I must first convince an IRS "board" of executives that TAS's proposed face-to-face training is necessary (substituting their judgment for mine, the head of office). If approved, that request next must be reviewed by the Deputy Commissioner's office and then, if the amount is over $24,999, by the Deputy Secretary's office. Meanwhile, the impacted employees are unable to work certain categories of cases because they have not had the requisite training, and other TAS employees must pick up the slack with respect to these cases. And of course, taxpayers are harmed because TAS employees do not have the training necessary to do their job. More importantly, if the IRS is unable to train and educate its employees properly, especially in methods of problem solving, issue identification, interviewing and communication techniques, and negotiation – all areas that are done best in a face-to-face learning environment – we will harm taxpayers and bring on the next crisis in U.S. tax administration. The last thing a financially struggling taxpayer should have to face is an under-trained IRS collection apparatus.

Do we really need or want to go down that road? Of course not. So here is my three-step recommendation for getting the IRS on the right track:

- First, we must enact an enforceable Taxpayer Bill of Rights that establishes the core principles of U.S. tax administration, and we must train our employees to analyze their actions (and inactions) so that IRS initiatives conform with these principles.
- Second, we must fund the IRS sufficiently so it can administer the tax system in accordance with those core principles of tax administration even as it discharges its dual mission of revenue collection and benefits administration.
- Third, we must restore training and training-related travel budgets to levels that ensure IRS employees have the education and professional skills they need to administer our complex tax system and do so in a manner that respects taxpayers rights.

34 *See* Interim Guidance Memorandum, Control No. CFO-01-1212-01 (Dec. 27, 2012) (issued pursuant to Treasury Directive 12-70 (Nov. 28, 2012), *at* http://www.treasury.gov/about/role-of-treasury/orders-directives/Pages/td12-70.aspx). The Deputy Commissioner herself can only approve training and travel up to $24,999. Any training or travel over that threshold must be sent to the Treasury Department for approval.

I respectfully submit this report for your consideration and action, and I stand ready to assist you in any way that I can.

Sincerely,

Nina E. Olson
National Taxpayer Advocate
25 June 2013

II. Executive Summary

The IRS must administer the requirements for tax-exempt status in a nonpartisan and even-handed manner.[1] When an organization seeks exempt status, it is essentially asking all other taxpayers for a contribution to its activities. Thus, the IRS has an obligation to review these applications closely.

According to a report by the Treasury Inspector General for Tax Administration (TIGTA), IRS Tax Exempt Organization (EO) function employees inappropriately selected for further review applications for tax-exempt status under Internal Revenue Code (IRC) § 501(c)(4) from organizations with "Tea Party" or similar terms in their names.[2] These terms were on a "Be on the Lookout" or BOLO list, which flagged 298 applicants for further review.[3] According to TIGTA, the IRS also asked the applicants unnecessary questions, including questions about donors, and delayed processing their applications while awaiting guidance about how to handle them. TIGTA found that IRS employees used inappropriate selection criteria because they did not understand the law or believed it was unworkable, and they created inappropriate job aids and information requests that were not vetted.

TAS has reviewed the TIGTA report, researched the applicable legal standards and IRS procedures, searched for TAS cases involving these issues, and reviewed known systemic issues in EO. Although TAS agrees with TIGTA's recommendations, we reviewed these materials to further analyze the causes of the problem, and determine why it was not identified or corrected sooner. Our goal was to develop additional recommendations to help prevent the problem from recurring and restore trust with the taxpaying public. A summary of TAS's findings and recommendations, which fall into four broad categories, follows:

A. Lack of Guidance and Transparency

The current legal standard that an organization may obtain exempt status under IRC § 501(c)(4) only if it is "primarily" engaged in social welfare activities is vague and difficult to administer in an objective manner. This legal ambiguity contributed to the problem, and until clearer legal standards are developed, EO may continue to face skepticism that its decisions are fair and consistent.

While applicants for exempt status under IRC § 501(c)(3) may obtain judicial review if they disagree with an adverse determination by EO (or if EO fails to take action on the application within a specified period of time), applicants for exempt status under § 501(c)(4) do

1 The IRS's mission is to apply the law *"with integrity and fairness to all."* IRM 1.1.1.1 (Mar. 1, 2006).

2 TIGTA, Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013) [*hereinafter* the TIGTA Report]. Unless otherwise indicated, all of the factual information discussed in this report about the IRS's handling of these cases comes from the TIGTA Report.

3 TIGTA Report at 8 (Figure 4).

not have that option. The absence of an opportunity for judicial review when EO fails to timely act on an application or concludes that the applicant is not entitled to § 501(c)(4) status has impaired the development of clearer legal standards that would assist the public and the IRS alike. It also allows the IRS to defer decisions indefinitely and leaves applicants without judicial recourse if they believe the IRS determination is wrong.

- The IRS, a tax agency, is required to make an inherently controversial determination about political activity that another agency, such as the Federal Election Commission (FEC), may be more qualified to make.
- The application form for exemption under IRC § 501(c)(4) does not make it easy for the IRS to identify excessive political activity without requesting additional information.
- It is difficult to assess an applicant's level of political activity before it has commenced operations.
- EO failed to incorporate its "instructions to staff" into the Internal Revenue Manual (IRM) and post them on the Internet as required by law. This lack of transparency reduced EO's accountability to the public and made it easier to believe that EO was arbitrarily singling out applications for further review based on ideology.
- EO did not clear many of its procedures with TAS or other stakeholders. If it had, inappropriate procedures could have been avoided or identified more quickly.

B. Absence of Adequate Checks and Balances

- There is no express taxpayer "right" to prompt service or to avoid intrusive inquiries. Thus, applicants for exemption were concerned about the situation but not empowered to know that the IRS was violating their rights.
- Even if applicants believed the IRS was violating their rights, they were left with few remedies when the IRS delayed IRC § 501(c)(4) applications and asked unnecessary questions.
- Congress no longer holds annual joint hearings to review IRS operations as it did in the five years following enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98).[4]

C. Management and Administrative Failures

- EO apparently did not have the meaningful performance measures required for effective management oversight, such as how long it takes, on average, to process applications that cannot be disposed of during initial screening. Nor did its systems allow

4 Pub. L. No. 105-206, 112 Stat. 685 (1998) [*hereinafter* RRA 98].

managers to know that its technical unit had delayed providing guidance or assistance. Better metrics would enable management to identify problems more quickly.

- The IRS automatically revoked the exemption of hundreds of thousands of organizations for failure to file a return, but EO had no administrative process to allow these organizations to appeal. As a result, it unnecessarily burdened organizations whose exemptions should not have been revoked, and it received about 30,000 more new applications for exemption, straining already limited resources.

D. EO's Cultural Difficulty with TAS

- EO executives did not agree that TAS could direct the IRS to take expedited action via a Taxpayer Assistance Order (TAO) in cases that do not meet EO's criteria for expedited handling in Revenue Procedure 2013-4 and IRM 7.20.2.10.[5] That disagreement contradicts EO's own IRM guidance and may have led to an environment in which EO employees very rarely referred organizations to TAS for assistance.[6] Had EO employees referred more of these cases to TAS, TAS probably would have identified the problem of systemic delay sooner.
- TAS's systemic advocacy function did not receive any complaints about a systemic problem with IRC § 501(c)(4) applications from EO employees or the affected organizations during this time.[7] Such complaints could have enabled TAS and EO to identify problems earlier.
- TAS received about 915,000 cases between January 1, 2010 and May 17, 2013, but only 19 were EO cases that may have been flagged using the inappropriate BOLO criteria.
- One local TAS office elevated cases of EO delay to TAS's National Office in February 2012. TAS's National Office raised its concerns with senior EO management in February 2012 and was told in March 2012 that procedures had been developed to begin processing a backlog of IRC § 501(c)(4) cases in a consistent manner. TAS continued to advocate with respect to the specific organizations, and the applications at issue were ultimately approved.

The National Taxpayer Advocate plans to make recommendations on this subject in her year-end report.[8] At a minimum, she recommends that Congress enact a Taxpayer Bill of Rights that sets forth ten broad rights, modeled on the U.S. Constitution's Bill of Rights, to help make existing rights clearer and help taxpayers better understand them. The National

5 Rev. Proc. 2013-4, § 9.03(3), 2013-1 IRB 126. IRC § 7811 provides the statutory authority for issuing TAOs.

6 IRM 7.20.2.18.2(1) ("When TAS determines that TE/GE...is not taking appropriate timely action on an issue for which TAS has issued an OAR, [TAS] may issue a...TAO instructing TE/GE ...to take immediate action to resolve the issue.") *See also* Service Level Agreement between the National Taxpayer Advocate and the Commissioner, Tax Exempt/Government Entities § VIII (May 29, 2009), *available at* http://www.irs.gov/file_source/pub/foia/ig/tas/sla_tas_tege_2009-05-29.pdf.

7 TAS searched submissions to its Systemic Advocacy Management System (SAMS) for the period January 2010 through November 2012.

8 IRC § 7803(c)(2)(B)(ii).

Taxpayer Advocate has made this recommendation in prior annual reports, and the treatment of § 501(c)(4) applicants violated most of the ten proposed taxpayer rights.[9]

We further recommend that Congress authorize the National Taxpayer Advocate to make symbolic "apology payments" of up to $1,000 to taxpayers where the IRS has caused excessive expense or undue burden to the taxpayer, and the taxpayer has experienced a significant hardship. This is something that tax administrations in a number of other countries already provide for.[10] For present purposes, we offer the following preliminary proposals for consideration and discussion by Congress and the IRS, which merit additional study, but are likely to evolve after further analysis:

E. Recommendations to Improve Guidance and Transparency

1. Clarify the level of political activity in which exempt organizations may engage and establish an objective test to identify when an organization exceeds that level. Any guidance developed by the IRS should be subject to public notice and comment so that the new guidance is not viewed as arbitrary and does not ignore the public's concerns.
2. Provide applicants for exemption under IRC § 501(c)(4) with the right to seek a declaratory judgment in federal court when the IRS fails to process their applications within nine months or the IRS has made an adverse determination.
3. Consider requiring another agency, such as the Federal Election Commission (FEC), to certify to the IRS that organizations are not engaged in excessive political campaign activity.
4. Make it easier for the IRS and the public to know when an applicant will be treated as violating the limits on excessive political campaign activity and when an application will be subject to additional review by:
   a. Applying additional review to all applicants that respond to a yes/no question on their application indicating a plan to support or oppose candidates for public office.
   b. Modifying the application forms to make it easier for the IRS to identify excessive political activity up front without using special selection criteria or burdening applicants with requests for more information.
   c. Gathering data from random audits and developing an objective risk model to deploy in compliance reviews of organizations after operations have commenced. The IRS should disclose the results (to the extent reasonable), and use that information to educate the EO community about why certain applications are flagged for further review and how to avoid being flagged or audited.

9 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*). For a discussion of which rights were violated, see National Taxpayer Advocate's *Preface, supra.*

10 *See* National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*).

5. Require that all IRS guidance and procedures that affect taxpayer rights in any way be cleared by TAS and other relevant internal stakeholders and incorporated into the public IRM, or at least vetted and posted to the Internet in the same manner as the IRM.[11] Along the same lines, the IRS should publish (in redacted form, if necessary), objective criteria that may trigger additional review as well as an audit technique guide developed after conducting the audits discussed above.

F. Recommendations to Improve Checks and Balances

6. Establish a Taxpayer Bill of Rights so that taxpayers understand their rights and remedies when they believe the IRS is not treating them fairly or violating other basic rights. In addition, if the delays and overly intrusive questions described by TIGTA had violated a specific taxpayer right and the organizations had sought "apology" payments from TAS, TAS might have identified the systemic problem earlier.
7. Reinstate the annual joint oversight hearings held after RRA 98 to help identify and address the IRS's problem areas, with specific focus on how the IRS is meeting the needs of particular taxpayer segments, including individuals, small businesses, and exempt organizations.

G. Recommendations to Improve EO Management

8. Upgrade EO's inventory management system so that managers can adequately monitor basic metrics such as case receipts, case age, cycle time, closures, requests for guidance, and other requests for EO services and assistance, even if a case is referred to the EO Technical Unit.
9. Adopt an administrative appeals process for exempt organizations whose exemption was automatically revoked for failure to file a return. Such a process might help reduce unnecessary taxpayer burden and minimize EO's backlog of new applications for exemption.

H. Recommendations to Improve EO's Cultural Difficulty with TAS

10. Provide guidance and mandatory training to EO employees to eliminate confusion about when to refer cases and systemic issues to TAS as well as about TAS's statutory authority to issue TAOs to expedite cases that do not necessarily meet EO's "expedite" criteria.[12] The guidance should be incorporated into the Internal Revenue Manual (IRM) or Internal Revenue Bulletin (IRB) and the training should be recorded so that new employees can view it.

11 These documents may be redacted, if necessary.

12 As discussed below, we understand that Tax Exempt/Government Entities Division (TE/GE) has agreed to work with TAS to issue guidance to EO staff about TAS's role and to have the National Taxpayer Advocate train EO employees on TAS case criteria, when to refer cases to TAS, and the TAO authority. TE/GE also intends to develop a formal process for initiating, tracking, and monitoring requests for assistance, using the existing system to minimize costs, and has accepted TAS's offer to assist with this endeavor.

In addition, TAS will take the following steps:

1. Train TAS case advocates on EO law, when to elevate EO cases to a TAS technical advisor or to TAS's National Office, when to recommend issuing a TAO, and when and how to refer EO systemic issues to TAS's Systemic Advocacy function.
2. Provide more advanced training on EO law to TAS technical advisors and higher-graded case advocates so they are better able to identify overly broad IRS inquiries.
3. Hire one or more TAS technical advisors with EO expertise to assist on specific cases, work to resolve systemic problems, and train existing technical advisors in this area.
4. Participate in a task force with EO to identify and address problems, and designate a liaison to work with the Cincinnati EO office.
5. Assist Tax Exempt/Government Entities Division (TE/GE) to implement the recommendations in this report.

III. Legal Background

The IRS is required to disallow applications for exemption under IRC § 501(c)(3) if the applicant will participate in political campaigns and under (c)(4) if the applicant's primary purpose is political.

Since enactment in 1913, the federal income tax has contained an exemption for non-profits organized and operated for "exclusively" charitable or general welfare purposes.[13] But the interpretation of the term "exclusively" is less clear-cut than it appears.

In 1945, the Supreme Court concluded that a single non-exempt purpose, "if substantial in nature, will destroy the exemption."[14] By implication, the organization litigating the case was permitted to have a non-exempt purpose that was insubstantial in nature yet still be considered organized and operating "exclusively" for exempt purposes.

In 1954, Congress enacted the unrelated business income tax, confirming that exempt organizations may conduct certain non-exempt activities.[15] Despite the statutory term "exclusively," regulations promulgated in 1959, and still in effect today, allow exempt status to organizations operating "primarily" for charitable purposes.[16]

The tax code contains provisions that directly address lobbying and political campaign activity. The Revenue Act of 1934 added a requirement that no substantial part of a charity's activity may be "attempting to influence legislation" (*i.e.*, lobbying).[17] Upon recodification in 1954, IRC § 501(c)(3) prohibited a charity from participating in political campaigns (*i.e.*, endorsing candidates).

Notably, the prohibition against political campaign participation under IRC § 501(c)(3) is not repeated under § 501(c)(4), which allows an exemption to an organization "operated *exclusively* for the promotion of social welfare."[18] The regulation under IRC § 501(c)(4) states that an "organization is operated *exclusively* for the promotion of social welfare if it is *primarily* engaged in promoting in some way the common good and general welfare of the people of the community."[19] Although the statute does not restrict lobbying or campaigning, the related regulation states that the promotion of social welfare does not include participation in campaigns for candidates.[20] In other words, an organization primarily engaged in political campaign activity is not considered to be engaged primarily in promot-

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

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

15 *See* IRC § 511 *et seq*.

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

17 Pub. L. No. 73-216, § 101, 48 Stat. 680, 700 (1934). Today, if an organization makes an election under IRC § 501(h), it can maintain exempt status as long as lobbying expenditures remain under a numerical ceiling, essentially a graduated portion of its operating budget, throughout a four-year period.

18 IRC § 501(c)(4)(A).

19 Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (emphasis added).

20 *See* Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

ing the common good and general welfare of the community for the purpose of receiving a tax exemption. Therefore, it is not eligible for tax-exempt status under § 501(c)(4).

While the regulations under IRC § 501(c)(3) do not quantify "primarily," they indicate that an organization is not engaged primarily in exempt activities "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."[21] In any case, the prevailing legal standard is that an organization formed under IRC § 501(c)(4) may participate in political campaigns as long as it is "primarily" engaged in social welfare.[22]

Political organizations that primarily engage in political activities are eligible for tax exemption under IRC § 527, but unlike IRC § 501(c)(3) and (c)(4) organizations, they are required to disclose donors to the public.

Organizations that do not qualify under IRC § 501(c)(3) or (c)(4) because they primarily engage in political activities may still qualify for tax exemption as "political organizations" under IRC § 527. Organizations establish § 527 status by filing a short notice with the IRS.[23] They must disclose the identity of their donors to the public on a monthly basis.[24] In addition, political organizations may be subject to the disclosure rules of the Federal Election Commission (FEC).[25]

By contrast, donors to IRC § 501(c)(3) and (4) organizations may remain undisclosed to the public, unless an organization discloses its donor list in connection with its application for exemption, which is open to the public.[26] Thus, organizations that do not want to disclose donors to the public may seek to qualify under § 501(c)(3) or (c)(4) instead of § 527.

The IRS must apply a facts-and-circumstances test to identify political activity based on the applicant's planned activity.

According to the IRS, the following factors tend to show that an organization's communication on a public policy issue is political campaign activity:[27]

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

22 Because the law restricts political action, the words describing the pertinent facts in specific cases often sound partisan or value-laden rather than descriptive. For example, in upholding the IRS's decision to revoke a church's exempt status when the church had paid for a full-page newspaper ad concerning a Presidential candidate, one court used the terms "Christian," "moral," and "Democratic." *See Branch Ministries v. Rossotti,* 211 F.3d 137 (D.C. Cir. 2000).

23 IRS Form 8871, *Political Organization Notice of Section 527 Status.*

24 *See* IRC § 6104 and 527. Political organizations are required to make monthly reports and annual returns, both of which include their donors. IRC § 527(i) and (j)(2), (3). In general, the IRS is required to make these documents and the Form 8871, *Political Organization Notice of Section 527 Status*, available on the Internet within 48 hours of receipt. *See* IRC § 527(k)(1).

25 *See* 2 U.S.C. ch. 14. For a discussion of the gaps between FEC and IRS regulations, see for example, Congressional Research Service (CRS), Rept. RS22895, *527 Groups and Campaign Activity: Analysis Under Campaign Finance and Tax Laws* (June 12, 2008); CRS, Rept. RL33888, *Section 527 Political Organizations: Background and Issues for Federal Election and Tax Laws* (Feb. 8, 2008); CRS, RL33377, *Tax-Exempt Organizations: Political Activity Restrictions and Disclosure Requirements* (Sept. 11, 2007).

26 *See* IRC § 6104(a)(1) (requiring that application materials be open to public inspection), 6104(d)(1) (requiring that annual returns be open to public inspection), and 6104(d)(3) (providing that contributors need not be disclosed on annual returns). *See also* Rev. Proc. 2013-9, § 8, 2013-2 I.R.B. 255; IRM 7.21.3.3.5.1(1)(k) (Aug. 1, 2003).

27 Rev. Rul. 2007-41, 2007-25 I.R.B. 1421; IRS Publication 4221-NC, *Compliance Guide for Tax-Exempt Organizations (Other than Charities)* 4-5 (Dec. 2010), *available at* http://www.irs.gov/file_source/pub/irs-pdf/p4221nc.pdf; IRS FS-2006-17 (Feb. 2006).

- The communication identifies one or more candidates for public office;
- The timing of the communication coincides with an electoral campaign;
- The communication targets voters in a particular election;
- The communication identifies the candidate's position on the public policy issue that is the subject of the communication;
- The position of the candidate on the public policy issue has been raised as distinguishing the candidate from others in the campaign, either in the communication itself or in other public communications; or
- The communication is not part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.

Factors that tend to show that the communication is *not* political campaign activity include the following:

- The absence of any one or more of the factors listed above;
- The communication identifies specific legislation, or a specific event outside the control of the organization, that the organization hopes to influence;
- The timing of the communication coincides with a specific event outside the control of the organization that the organization hopes to influence, such as a legislative vote or other major legislative action (for example, a hearing before a legislative committee on the issue that is the subject of the communication);
- The communication identifies the candidate solely as a government official who is in a position to act on the public policy issue in connection with the specific event (such as a legislator who is eligible to vote on the legislation); or
- The communication identifies the candidate solely on the list of key or principal sponsors of the legislation that is the subject of the communication.

The IRS must also apply other facts-and-circumstances tests to determine whether voter guides, websites, and public forums constitute political campaign activity.[28] Although the IRS routinely applies facts-and-circumstances tests to existing organizations as well as in other contexts (*e.g.*, determining whether a business expense is ordinary and necessary under IRC § 162), these tests are more challenging to apply to newly-formed organizations that are applying for an exemption because the IRS has to apply them based on what the organization plans to do in the future. Groups on both sides of the political spectrum have

28 Treas. Reg. § 1.501(c)(3)-1; Rev. Rul. 2007-41, 2007-25 I.R.B. 1421; IRS Publication 4221-NC, *Compliance Guide for Tax-Exempt Organizations (Other than 501(c)(3) Public Charities and Private Foundation)* 4-5 (Dec. 2010), *available at* http://www.irs.gov/file_source/pub/irs-pdf/p4221nc.pdf; IRS FS-2006-17 (Feb. 2006). *See also* Rev. Rul. 78-248, 1978-1 C.B. 154 (voter education) and Rev. Rul. 86-95, 1986-2 C.B. 73 (public forums).

voiced concerns that the IRS was either doing too much or not enough to enforce the political activity prohibitions.[29]

29 *See, e.g.,* Letter from Chairman of the Senate Finance Committee to IRS Commissioner, *Baucus Calls On IRS to Investigate Use of Tax-Exempt Groups for Political Activity* (Sept. 29, 2010), *available at* http://www.finance.senate.gov/newsroom/chairman/release/?id=9bc04792-1ead-4668-a512-89443f342312; Letter from twelve Senators to IRS Commissioner, *Senators to IRS: Don't Let Politics Trump Policy on Non-Profit Group Designations* (Mar. 14, 2012), available at http://www.finance.senate.gov/newsroom/ranking/release/?id=b49bd610-6a0f-4ea5-bea2-8ce37e2e5e04.

IV. Procedural Background

In or about 2010, the IRS began to receive a number of applications for tax-exempt status from organizations that appeared to be associated with political activities.[30] Under IRC § 501(c)(3), as noted above, an organization cannot qualify for tax-exempt status if it plans to engage in any political activity. Under IRC § 501(c)(4), an organization can qualify for tax-exempt status if it plans to engage in some political activity, but only if it operates "primarily" for social welfare purposes.

There is very little guidance to help the IRS (or the public) determine whether an organization is operating "primarily" for social welfare purposes. Without guidance, it is difficult to measure "primarily" in an objective way. As we discuss below, the rules governing qualification for IRC § 501(c)(4) status should be clarified.

IRS screeners used check sheets to identify cases requiring further review.

The first step in processing applications for exemption is for an IRS screener to categorize them.[31] Some are approved by the screener on "first read," but those that require additional development are assigned to an EO Determinations Unit specialist in Cincinnati, Ohio. Certain cases, including those "where issues cannot be resolved by established precedent," must be worked by an EO Technical Unit specialist in Washington, DC.[32] The screeners try to identify cases that need to be processed by the Technical Unit before they are assigned to a Determinations specialist.[33] They use simple check sheets to identify these cases.[34]

Tea Party applications for tax exemption were screened into a category that received further review as "potential political" organizations.

Between May 2010 and June 2011, the IRS Determinations Unit developed and used a "Be on the Look Out" (BOLO) listing to flag, for additional review, applications from organizations with terms such as "Tea Party," "Patriot," or "9/12" in their names, according to TIGTA.[35] About one-third of the cases flagged for additional review contained these

30 TIGTA Report at 30 (referencing a high profile case).

31 IRM 21.3.8.11.1.1(5) (Oct. 1, 2010).

32 IRM 7.20.1.4 (Dec. 20, 2012).

33 IRM 7.20.2.3.2(7) (Aug. 24, 2012) (indicating that if the application involves "an issue or activity listed on Form 14259, *EO Determinations Screening Checksheet*," then the screener will [send the case for managerial approval]; If the manager agrees with the screener's recommendation, the case will be assigned to "Centralized Unassigned Inventory."). As discussed below, TAS could not readily locate the Form 14259, *EO Determinations Screening Checksheet in the IRM, on the IRS intranet or on the Internet*.

34 IRS, Form 14259, *EO Determinations Screening Checksheet;* IRM 7.20.2.14 (Aug. 24, 2012) (listing many other forms, including check sheets and similar job aids used by EO employees in connection with the determination process).

35 TIGTA Report at 6. Later in 2010, the IRS received additional pressure to scrutinize applications under IRC § 501(c)(4) from political organizations that did not want to disclose their donors. For example, on October 5, 2010, two watchdog groups sent a letter to the IRS making this allegation with respect to a particular organization. *See* Letter from Campaign Legal Center and Democracy 21 to IRS (Oct. 5, 2010), *reprinted as Watchdog Groups Call on IRS to Investigate Tax Status of Crossroads GPS*, 2013 TNT 101-29 (Mar. 24, 2013). Similar accounts appeared in the news, alleging that the IRS would not detect any problems with these organizations until after the election – when they file their first return. *See, e.g.*, M. Luo and S. Strom, *Donors' Names Kept Secret as They Influence the Midterms*, The New York Times (Sept. 21, 2010). The IRS had also received inquiries from Congress. TIGTA Report at 1.

terms and two-thirds did not.[36] Because these criteria did not align with the facts-and-circumstances test the IRS was supposed to apply, some organizations were burdened with unnecessary requests for information, and their cases were delayed.[37]

According to TIGTA, IRS employees used inappropriate BOLO selection criteria because they did not understand the law or believed it was unworkable, and they created inappropriate job aids that were not vetted.[38] The employees presumably assumed that an application for tax exemption from an organization with "Tea Party" or similar terms in its name was more likely to be focused primarily on political activity, rather than the common good and general welfare, as required by law.

In July 2011, after IRS management learned of the inappropriate BOLO criteria, it changed them to mirror the legal and regulatory requirements.[39] In January 2012, believing that the July 2011 criteria were unworkable, the Determinations Unit changed them again, according to TIGTA.[40] Three months later, management learned the BOLO criteria had been changed, revised the criteria again, and issued a memorandum in May 2012, requiring all changes to be approved at the executive level prior to implementation.[41]

The IRS specialist(s) assigned to work on these "potential political" cases put them on hold from October 2010 through November 2011, while awaiting assistance and guidance from the IRS Technical Unit, resulting in a 13-month delay.[42] Processing resumed in November 2011 without guidance.[43] As of February 2013, the guidance still had not been finalized because the EO function decided to provide training instead.[44]

When the IRS began working the potential political cases, employees initially requested excessive information, including donor lists.[45] These requests burdened applicants and further delayed IRS approval of their applications. The IRS's request for donor lists also meant that donors would be disclosed to the public.

36 TIGTA Report at 8.

37 TIGTA Report at 6.

38 TIGTA Report at 18 (attributing the BOLO criteria to "insufficient oversight provided by management... [a failure to] consider the public perception of using politically sensitive criteria...[, and] a lack of knowledge in the Determinations Unit of what activities are allowed...").

39 TIGTA Report at 7.

40 Id. *See also* TIGTA Report at 37.

41 *Id.* As discussed below, neither the BOLO criteria nor the memo requiring executive review of changes to the BOLO criteria were cleared or vetted by TAS. Nor are they available, even in redacted form, on the Internet. However, as this report was in the final editing stages, TAS received a draft IRM that included the memo.

42 TIGTA Report at 13-14 ("the Determinations Unit Program Manager thought the cases were being processed. Later, [TIGTA was] informed by the Director, Rulings and Agreements, that there was a miscommunication about processing the cases. The Determinations Unit waited for assistance from the Technical Unit instead of continuing to process the cases. The Determinations Unit Program Manager requested status updates on the request for assistance several times via e-mail. Draft written guidance was not received from the Technical Unit until November 2011, 13 months after the Determinations Unit stopped processing the cases.").

43 *Id.*

44 TIGTA Report at 14. No written training materials were cleared by TAS and TAS could not locate them on the IRS website.

45 TIGTA Report at 20 (listing the seven questions) and 39-40 (timeline).

While organizations can begin operating as tax-exempt under IRC § 501(c)(4) before receiving a determination letter from the IRS and none of the applications were denied, IRS delays harmed organizations because some gave up and withdrew their applications.[46] Moreover, if organizations are approved for tax-exempt status, it may be easier to obtain donations, and they may receive exemption from certain state taxes along with reduced postal rates, so the delays may also have harmed them in these respects.[47]

46 TIGTA Report at 14 ("For the 296 potential political cases we reviewed, as of December 17, 2012, 108 applications had been approved, 28 were withdrawn by the applicant, none had been denied, and 160 cases were open from 206 to 1,138 calendar days..."). In addition, applicants may have been concerned that their application, including donor lists, would be available to the public, as would have been the case if they had applied for exemption as political organizations under IRC § 527. However, the IRS later destroyed the donor lists, according to TIGTA.

47 TIGTA Report at 12.

V. Discussion and Preliminary Recommendations

The National Taxpayer Advocate plans to make more definitive recommendations in her year-end report.[48] This discussion offers some preliminary recommendations that merit further study, but many are likely to evolve after further discussion and analysis.

A. Lack of Guidance and Transparency

Ambiguity in the law presents significant challenges for the IRS, as it attempts to enforce limits on political campaign activity in a fair and consistent manner. Moreover, the IRS's failure to vet and publish its guidance created the impression the IRS was acting arbitrarily and denied stakeholders, including TAS, the opportunity to help prevent the IRS from using ill-advised procedures.

It is difficult to determine whether an organization violates the limits on political campaign activity because the limits are not clearly defined.

As noted above, IRC § 501(c)(4) allows an exemption to an organization "operated *exclusively* for the promotion of social welfare," and the regulation under IRC § 501(c)(4) states that an "organization is operated *exclusively* for the promotion of social welfare if it is *primarily* engaged in promoting in some way the common good and general welfare of the people of the community."[49] There is very little guidance to help the IRS determine whether an organization is operating "primarily" for social welfare purposes. Among the open questions:

- Is there a fixed percentage that should be used to measure whether an entity is "primarily" engaged in social welfare activities (*e.g.,* 51 percent)?
- Is any single factor dispositive or overriding? In seeking to measure whether an entity is "primarily" engaged in social welfare activities, one could focus on the percentage of the entity's expenditures, the percentage of the entity's time, the percentage of the entity's email blasts or advertisements, or other factors.
- If the IRS considers multiple factors, should all factors receive equal weight, and if not, how should the relative weighting be determined?

Historically, the IRS received relatively few applications for IRC § 501(c)(4) status from organizations seeking to engage in political campaign activity, and it evaluated those applications on a case-by-case basis. It is not clear to TAS whether the IRS ever developed a list of criteria to help make determinations in those cases, and if so, whether the criteria were reasonable. What is clear from the TIGTA report is that IRS EO staff did not believe they had sufficient criteria to make fair and consistent decisions.[50]

48 IRC § 7803(c)(2)(B)(ii).

49 Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (emphasis added).

50 TIGTA Report at 7, 18, and 38.

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

Congress could decide to ban any political campaign activity by exempt organizations on the theory that the taxpaying public should not be required to subsidize those activities.[51] Alternatively, it could allow unlimited political campaign activity on the theory that taxpayers should be required to underwrite the cost of elections, as elections are essential to maintaining a democracy. Either approach would be much easier for the public to understand and for the IRS to administer.[52] A third alternative would be for Congress to clarify the meaning of "primarily."

Failing that, the IRS and Treasury should develop a proposed regulation or revenue procedure that lists the factors IRS will apply and proposes a specific and detailed method for applying them. The guidance should explain how to apply the test to organizations before they have commenced operations. The IRS and Treasury should request public comment on this proposal to improve the guidance and to ensure that its process is transparent.

> **Recommendation:** *Clarify the level of political activity that exempt organizations may conduct, and establish an objective test to identify when an organization exceeds that level.*

Guidance has not developed, in part, because there is no judicial review of applications for exemption under IRC § 501(c)(4).

Most IRC § 501(c)(3) organizations must apply to the IRS for exempt status.[53] If denied or unanswered after about nine months (270 days), an IRC § 501(c)(3) applicant may have judicial recourse to a declaratory judgment on exempt status, upon exhausting administrative remedies.[54] However, applicants for IRC § 501(c)(4) status currently have no judicial recourse.

There are reasons for this difference in treatment. Most notably, organizations seeking IRC § 501(c)(3) status generally must apply to the IRS, and the ability of their donors to claim tax deductions hangs in the balance. By contrast, organizations may treat themselves as qualified under IRC § 501(c)(4) without obtaining an IRS ruling, and contributions are not

51 Form 1040, *U.S. Individual Income Tax Return,* includes a checkbox to indicate whether taxpayers would like to designate a portion of their payment to go to the Presidential election campaign fund. Even though taxpayers pay the same amount of tax regardless of their choice, less than 10 percent chose to have their taxes fund the campaign. *See, e.g.,* IRS, Statistics of Income, Individual Income Tax Returns, Historical Table 1 (TY 1999-2011), www.irs.gov/file_source/pub/irs-soi/histab1.xls.

52 Another possibility would be to require the rapid disclosure of all major donors by all exempt organizations that engage in any political activity, as is required of IRC § 527 organizations. Thus, there would be less of an incentive for political organizations to apply for exemption under IRC § 501(c)(4).

53 *See* IRC § 508. *See also* IRS Publication 557, *Tax-Exempt Status for Your Organization* (Oct. 2011).

54 *See* IRC § 7428.

tax deductible by donors. Still, many if not most organizations planning to claim IRC § 501(c)(4) status file applications with the IRS.

Judicial review would ensure that applicants do not have to wait indefinitely, and it would ensure that organizations that disagree with an IRS denial can have their day in court. Under this proposal, recourse similar to that for IRC § 501(c)(3) charities would apply when an application for recognition of § 501(c)(4) status languishes for nine months. This would increase the IRS's accountability for delays. More importantly, the resulting decisions could help to provide guidance concerning excessive political activity. Judicial review would also give applicants another remedy to address actual or perceived partisanship.

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

The IRS, a tax agency, is assigned to make an inherently controversial determination about political activity that another agency may be more qualified to make.

It may be advisable to separate political determinations from the function of revenue collection. Under several existing provisions that require non-tax expertise, the IRS relies on substantive determinations from an agency with programmatic knowledge.[55]

Potentially, legislation could authorize the IRS to rely on a determination of political activity from the Federal Election Commission (FEC) or other programmatic agency. Specifically, the FEC would have to determine that proposed activity would not or does not constitute excessive political campaign activity.

A second step would be to confirm that the proposed activity is educational or otherwise charitable. In the case of a feminist newspaper and educational organization, the IRS denied a 1974 application for exempt status in part because the applicant engaged in "political and legislative commentary" as well as "promoting lesbianism."[56] In such a case, the FEC might be more competent than the IRS to determine whether the commentary amounted to substantial campaigning or lobbying.

On the educational content, it is unclear whether the FEC or perhaps the Education Department would have to apply IRS rules.[57] Similarly, applications may require distinguishing between campaigns and religious activity arguably within the purview of the Office of Faith-Based and Community Initiatives or another agency.[58] At the end of the day,

55 *See, e.g.*, IRC § 47 (relating to historic rehabilitation credits certified by the Secretary of the Interior); IRC § 48C (relating to energy credits for which the IRS must consult with the Secretary of Energy regarding certifications).

56 *Big Mama Rag*, Inc. v. U.S., 631 F.2d 1030 (D.C. Cir. 1980) (reversing summary judgment for the IRS and remanding for determination of exempt status).

57 *See* Treas. Reg. § 1.501(c)(3)-1(d)(3) (defining "educational"); Rev. Proc. 86-43, 1986-2 C.B. 729 (criteria used by the IRS to determine when advocacy is considered educational).

58 *See Branch Ministries v. Rossotti*, 211 F.3d 137 (D.C. Cir. 2000).

identification of proscribed political activity may be inextricable from a determination of charitable purpose, which in turn could require expertise in a range of fields, and that is a potential weakness of proposals to outsource the determination to another agency that should be carefully considered.

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

The form used by applicants for exemption does not make it easy for the IRS to identify excessive political activity.

Upon application for tax-exemption, the IRS must confirm that an organization will operate for exempt purposes without proscribed activity, such as excessive political campaigning. The application form used by applicants for exemption under IRC § 501(c)(3), Form 1023 (*Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*) asks a yes or no question about whether the organization will support or oppose political candidates. In parallel, the application form used by applicants for exemption under IRC § 501(c)(4), Form 1024 (*Application for Recognition of Exemption Under Section 501(a)*) asks if the organization plans to spend any money to influence the selection of any candidate.

Form 1024 has not been revised since 1998 – 15 years ago. Adding relevant questions to Form 1024 could help the IRS make a determination about excessive political activity.[59] Requiring all IRC § 501(c)(4) applicants to answer further questions would reduce concerns about partisanship and reduce the IRS's need to burden organizations with follow-up requests. Moreover, with additional information available to the IRS on the application, it may be able to approve more applications during its "first read" process, thereby reducing the number of requests it makes for follow-up information, which in turn might reduce delays and the backlog of cases awaiting development.

Additionally, more detailed questions could help educate applicants about activity that could potentially disqualify the organization and enable them to provide relevant information with their applications to proactively address the IRS's potential concerns. Finally, with the benefit of answers to specific questions, it might be easier for the IRS to determine during an audit whether an applicant's subsequent political activity significantly exceeds the activity described on the Form 1024.

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

59 *See* Rev. Rul. 2007-41, 2007-25 I.R.B. 1421.

It is difficult to assess an applicant's level of political activity before operations have commenced.

Because judicial review of determinations is limited to those under IRC § 501(c)(3) and because of the inadequacy of Form 1024, there is little case law or other guidance available to the IRS and applicants under IRC § 501(c)(4) regarding limits on political campaign activity. There is even less guidance about how to apply these limits to organizations whose operations have not yet commenced.

The IRS should undertake a random audit of existing IRC § 501(c)(4) organizations to identify compliance risks, as it does in connection with its National Research Program (NRP).[60] This random audit initiative would be nonpartisan (*i.e.*, it would consist of random audits based on objective sampling techniques), forming a baseline for future audits. The benefit of a robust, random audit-based compliance strategy is that, after the IRS analyzes the results of its random audits, it could focus subsequent audits on those organizations that (based on the data) present the greatest risks of noncompliance. These audits might be more straightforward than reviewing applications for exemption because they would be conducted after operations have commenced. In addition, these audits would likely generate additional guidance about how to apply the limits on political campaign activity. Such guidance would be helpful for both the IRS and organizations. The IRS could also use this guidance to conduct better education and outreach.

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

EO's failure to post its procedures to the Internet appeared to violate the law and contributed to the problem.

The IRS is required to post on its website all "instructions to staff that affect a member of the public," unless an exemption applies.[61] Even if an exemption applies, it is supposed to "clear" most guidance internally with affected program owners and "specialized reviewers," such as TAS, and incorporate it into the Internal Revenue Manual (IRM) (in redacted form, if necessary).[62] As the National Taxpayer Advocate has previously reported, the IRS

60 For reports on previous Political Activity Compliance Initiatives, see e.g. www.irs.gov/pub/irs-tege/2006paci_report_5-30-07.pdf, www.irs.gov/pub/irs-tege/final_paci_report.pdf (last visited June 11, 2013). For reports on exempt industries, see e.g. Colleges & Universities Compliance Project, www.irs.gov/pub/irs-tege/CUCP_FinalRpt_042513.pdf (last visited June 11, 2013); Hospital Compliance Project, www.irs.gov/pub/irs-tege/frepthospproj.pdf (last visited June 11, 2013). IRS EO Annual Work Plans are posted at http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/EO-Implementing-Guidelines-and-Work-Plan (last visited June 11, 2013).

61 *See generally* 5 U.S.C. § 552.

62 *See generally* IRM 1.11.9.3 (Dec. 28, 2010); IRM 1.11.9.4 (Nov. 1, 2011).

does not always consistently and timely clear or post its guidance, or incorporate it into the IRM.[63]

More specifically, EO is supposed to incorporate its instructions to staff into the IRM.[64] If it had done so, its guidance would have been cleared with TAS and other stakeholders, and published on the Internet. However, EO did not clear with TAS or post on the Internet, even in redacted form:

- The BOLO criteria;
- The training materials, if any, used for the training that TIGTA suggested EO provided to its employees in lieu of issuing guidance concerning how to process "potential political" cases;[65]
- The form letters, if any, used to request additional information;
- Form 14259, *EO Determinations Screening Checksheet,* or the other forms and job aids that EO employees use in connection with the determination process;[66]
- The script that EO developed in May 2012 to inform applicants that it no longer needs some of the information it requested; [67]
- May 2012 changes to the content of EO determination letters;[68] or
- The May 2012 memo, which required that changes to the BOLO criteria be approved at the executive level prior to implementation.[69]

Even today, these documents are not posted to the Internet and TAS has not located them on the IRS Intranet.[70] The IRS may have failed to post and clear this guidance because it only posts guidance that "affects how a member of the public files, pays, complies with their tax requirements, or interacts with the Service."[71] EO employees may have believed these documents did not affect how a member of the public "files, pays, complies, or interacts with the IRS," and thus did not need to be disclosed.

63 *See* National Taxpayer Advocate 2006 Annual Report to Congress 10-30 (Most Serious Problem: *Transparency of the IRS*); National Taxpayer Advocate FY 2008 Objectives Report to Congress xxi-xxvii (*Update on Transparency of the IRS*); National Taxpayer Advocate 2010 Annual Report to Congress 71-84 (Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review*); and National Taxpayer Advocate 2011 Annual Report to Congress 380-403 (Most Serious Problem: *The IRS's Failure to Consistently Vet and Disclose Its Procedures Harms Taxpayers, Deprives It of Valuable Comments, and Violates The Law*).

64 IRM 1.11.2.2 (Mar. 11, 2012); IRM 1.11.10.2 (Nov. 1, 2011).

65 TIGTA Report at 14 ("As of the end of our audit work in February 2013, the guidance had not been finalized because the EO function decided to provide training instead"). It is not clear if this training was held, or if it was held, whether the IRS developed written materials.

66 IRM 7.20.2.14 (Aug. 24, 2012).

67 TIGTA Report at 42.

68 *Id*.

69 TIGTA Report at 7.

70 We understand that the May 2012 memo will soon be posted.

71 IRM 1.11.10.3.1 (Nov. 1, 2011); IRM 1.11.10.7.1 (Feb. 7, 2013). TAS has raised concerns that this test is narrower than the statutory requirement in 5 U.S.C. § 552 for public disclosure.

Regardless of the reason, the IRS's failure to post instructions to staff that obviously "affect[ed] a member of the public" (as seemingly required by law) increased the risk that it would act or be perceived as acting arbitrarily and inconsistently. For example, if EO had posted its standard request for additional information from potential political organizations on the Internet, the affected organizations would be less likely to believe the questions were arbitrary, even if they did not agree that the questions were appropriate.

Presumably for this reason, TIGTA recommended – although the IRS did not agree in its written response – that the IRS document the reason(s) applications are chosen for additional review (*e.g.*, evidence of specific political campaign intervention in the application file).[72] TIGTA also recommended the IRS develop and publish on the Internet the procedures IRS specialists should use to process requests for tax-exempt status involving significant campaign intervention – a recommendation that, as noted above, could also improve the quality of the applications the IRS receives.[73]

Along the same lines, the IRS could publish, in advance, more specific objective criteria that would be used to select organizations for further review.[74] In fact, in response to the National Taxpayer Advocate's 2007 Annual Report to Congress, the IRS agreed that putting guide sheets for processing applications for tax-exempt status on its Internet site would reduce delays.[75] The IRS could use data from reviews of affected organizations,[76] or industries,[77] and the results of random audits (as recommended above) to develop this criteria and include it in its annual work plan.[78] This could increase the perceived consistency and impartiality of the IRS. The IRS could obviously redact material that would "reasonably be expected to risk circumvention of the law," such as tolerances.[79]

Recommendation: *Publish on the Internet objective criteria that may trigger additional review of applications for exemption and the procedures IRS specialists*

72 TIGTA Report at 11. We understand the IRS has now agreed to implement all of TIGTA's recommendations.

73 TIGTA Report at 16-17 (recommending the IRS "[d]evelop guidance for specialists on how to process requests for tax-exempt status involving potentially significant political campaign intervention. This guidance should also be posted to the Internet to provide transparency to organizations on the application process.... [S]pecific guidance should be developed and made available to specialists processing potential political cases. Making this guidance available on the Internet for organizations could also address a concern raised in the IRS's response that many applications appear to contain incomplete and inconsistent information.").

74 Congress's special concerns about transparency in audit selection are reflected RRA 98, which requires the IRS to incorporate into Publication 1 the criteria and procedures for selecting taxpayers for examination, including whether taxpayers are selected for examination on the basis of information available in the media or provided by informants. Pub. L. No. 105-206, § 3503(a), 112 Stat. 685, 771 (1998).

75 National Taxpayer Advocate 2007 Annual Report to Congress 210, 213 (Most Serious Problem: *Determination Letter Process*).

76 For reports on Political Activity Compliance Initiatives, *see e.g.*, www.irs.gov/pub/irs-tege/2006paci_report_5-30-07.pdf, and www.irs.gov/pub/irs-tege/final_paci_report.pdf (last visited June 11, 2013).

77 For reports on exempt industries, *see e.g.*, Colleges & Universities Compliance Project, www.irs.gov/pub/irs-tege/CUCP_FinalRpt_042513.pdf (last visited June 11, 2013); Hospital Compliance Project, www.irs.gov/pub/irs-tege/frepthospproj.pdf (last visited June 11, 2013).

78 IRS EO Annual Work Plans are posted at http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/EO-Implementing-Guidelines-and-Work-Plan (last visited June 11, 2013).

79 5 U.S.C § 552(b)(7)(E). While there are other types of law enforcement exemptions, they are generally inapplicable in the context of this discussion. 5 U.S.C. § 552(b)(7). Disclosing general and objective criteria is most likely to promote compliance with the law, rather than circumvention. The IRS already takes steps in this direction when it discloses its examination work plans and audit technique guides.

use to process applications involving political campaign activity.

EO's failure to clear its procedures with TAS and other stakeholders bypassed an important safeguard of taxpayer rights.

Had these documents (listed above) been vetted by TAS, TAS would have had an opportunity to raise concerns before implementation, potentially averting or mitigating the problems described by TIGTA. In FY 2012, the IRS accepted about 70 percent of TAS's comments in connection with the guidance that it cleared with TAS.[80] The IRS's failure to clear documents with TAS increases the risk the IRS will establish ill-advised procedures that harm taxpayers.

The IRS's failure to clear guidance that affects taxpayers with TAS also impedes TAS's statutory function. TAS has a statutory duty to "identify areas in which taxpayers have problems in dealings with the Internal Revenue Service [and]... propose changes in the administrative practices of the Internal Revenue Service to mitigate [these] problems.[81] TAS cannot fulfill this duty if it is not aware of the IRS's administrative practices because the IRS has failed to write them down and clear them with TAS.[82]

The IRS's failure to clear non-IRM guidance with TAS is not unique to TE/GE or the BOLO criteria. Unlike changes to the IRM, the IRS does not have procedures for clearing "instructions to the public" with TAS.[83] For example, it does not usually clear letters, notices, forms, publications, and frequently asked questions (FAQs) with TAS, even though the public and IRS employees rely on them.[84] Nor does it clear more informal guidance raising taxpayer rights concerns with TAS, such as audit technique guides (ATGs), which contain guidance about how to audit taxpayers in certain industries, or so-called "local" guidance.[85] Similarly, it does not clear programming changes, such as changes to the reasonable cause assistant or automated case-routing criteria, with TAS.[86]

Without reforms to the IRS's process for clearing all types of guidance that affect taxpayer rights with internal stakeholders, including TAS – the voice of the taxpayer inside the IRS

80 *TAS Business Performance Review*, FY 2012, 4th Qtr., 3 (FY 2012).

81 IRC § 7803(c)(2)(A)(ii)-(iii).

82 Keeping the BOLO list on an Excel spreadsheet accessible to only EO personnel means that TAS and other stakeholders did not have an opportunity to identify any problems with the BOLO criteria.

83 *See, e.g.,* IRM 1.17.3.5.2 (Nov. 16, 2012) (requiring IRS forms, instructions, publications, and certain letters to be cleared, but not necessarily by TAS); IRM 1.17.1.5 (Dec. 10, 2012) (same); IRM 1.17.8.5.1.1.1 (Nov. 19, 2012) (same); IRM 1.17.8.5.1.1.3 (Nov. 19, 2012) (internal use forms); IRM 1.17.8.5.1.3.1 (11-19-2012) (requiring certain items to be cleared through OMB, but TAS is not mentioned).

84 The IRS occasionally asks TAS to review letters, notices, forms, and publications, but it is not required to provide TAS with an opportunity to review these documents.

85 IRM 4.28.1.2.4 (Mar. 4, 2008) (requiring audit technique guides to be cleared but not necessarily by TAS). "Local procedures" do not need to be incorporated into the IRM or cleared in accordance with normal procedures. IRM 1.11.2.2 (Mar. 11, 2012). Thus, the Determination Unit in Cincinnati might have believed it was not required to incorporate its procedures into the IRM or clear them with TAS. TAS has raised concerns about the local procedure exception for this reason. *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 380, 384 n.27.

86 *See* National Taxpayer Advocate 2010 Annual Report to Congress 71-84. TAS was not asked to clear the checklists used by EO to screen applications for exemption. Nor are the checklists readily available for TAS's review on the IRS Intranet.

– there will continue to be an elevated and unnecessary risk that the IRS will implement ill-advised guidance and procedures that ignore taxpayer concerns. In subsequent discussions with TAS, TE/GE has agreed to be more transparent by sharing its guidance with TAS, but more expansive changes are necessary throughout the IRS.

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

B. Absence of Adequate Checks and Balances

The public itself can serve as an important check on the IRS's power if it is informed about when the IRS's procedures are violating taxpayer rights and how to flag those violations. Once violations are flagged by the public, IRS management and oversight bodies could address them.

EO violated the principles underlying a number of fundamental taxpayer rights.

While Congress has enacted various taxpayer rights,[87] survey results suggest that less than 50 percent of taxpayers believe they have rights, and even fewer know what their rights are.[88] Thus, the National Taxpayer Advocate has previously recommended that Congress enact a Taxpayer Bill of Rights (TBOR) to codify and summarize taxpayers' existing rights and responsibilities by grouping them into the following simple, easy-to-understand categories:[89]

Ten Taxpayer Rights: (1) the right to be informed; (2) the right to be assisted; (3) the right to be heard; (4) the right to pay no more than the correct amount of tax; (5) the right of appeal; (6) the right to certainty; (7) the right to privacy; (8) the right to confidentiality; (9) the right to representation; and (10) the right to a fair and just tax system.

Five Taxpayer Responsibilities or Obligations: (1) the obligation to be honest; (2) the obligation to be cooperative; (3) the obligation to provide accurate information and documents on time; (4) the obligation to keep records; and (5) the obligation to pay taxes on time.

Clearly stating taxpayer rights and responsibilities will remind taxpayers that rights imply responsibilities. When the government establishes, communicates, and respects taxpayers'

87 *See, e.g.*, RRA 98; Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996); Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (1988).

88 Forrester Research Omnibus Mail Survey for the Taxpayer Advocate Service (Sept. 17, 2012); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 131.

89 For the proposal and a detailed analysis of each specific right, see National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*) and National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*). For legislative activity incorporating this recommendation in whole or in part, see Taxpayer Bill of Rights Act of 2010, S. 3215 and H.R. 5047, 111th Cong. (2010); H.R. 5716, 110th Cong. (2008).

rights, it also shows taxpayers that the government respects its citizens. Research suggests that some taxpayers are likely to respond by making an extra effort to pay their taxes voluntarily and timely.[90]

The problems identified by TIGTA appear to have violated the fundamental right to be informed, to be assisted, to certainty, to an appeal, and to a fair and just tax system, among others.[91] If these rights were enacted and publicized, along with adequate remedies, IRS employees might be less likely to violate rights by creating seemingly unfair BOLO criteria, allowing applicants who sought assistance and information about their applications to remain uninformed, automatically revoking exemptions without providing for an appeal (as described below), or requesting burdensome and seemingly unnecessary information without explanation or transparency. Moreover, faced with these violations, applicants for exemption may have complained more promptly and the violations might have been addressed more quickly.

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

Applicants for exemption (and others) have no remedy for the violation of their rights.

Even if taxpayers know their rights, they will be unlikely to assert them if they believe there is no adequate and easily available remedy for the violation of those rights. Under current law, there are no adequate remedies for the violation of most taxpayer rights.[92] Even a general remedy for damages would not compensate for violations that cause frustration, confusion, anxiety, or wasted time.

As discussed in the National Taxpayer Advocate 2007 Annual Report to Congress, Australia and the United Kingdom have adopted "apology" payments (or an equivalent) as a remedy for the violation of taxpayer rights.[93] The National Taxpayer Advocate included a recommendation in that report for Congress to adopt a similar system in the U.S. The proposal would grant non-delegable, discretionary authority to the National Taxpayer Advocate to make a payment of up to $1,000 to a taxpayer where the action or inaction of the IRS caused excessive expense or undue burden, and the taxpayer experienced a "significant hardship" within the meaning of IRC § 7811.[94] The aggregate payments under this proposal would be limited to $1 million per year unless otherwise authorized by Congress

90 *See, e.g., Voluntary Compliance Study; Lavoie 2009.*

91 *See Preface, supra,* for the National Taxpayer Advocate's detailed analysis of the specific rights compromised relating to EO applications covered in the TIGTA report.

92 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 131.

93 National Taxpayer Advocate 2007 Annual Report to Congress 478-489.

94 *Id.*

The rationale for an apology payment is not to compensate the taxpayer fully for his or her time and frustration, but to serve as a symbolic gesture to show that the government recognizes its mistake and the taxpayer's burden. These payments might enhance the public perception of the IRS and the tax system as just and fair. The National Taxpayer Advocate could also include a general description of apology payments authorized during the preceding year in her annual reports to Congress. This would keep Congress and the IRS apprised of the nature of significant IRS errors and highlight areas that might warrant attention by policymakers.

If apology payments were allowed by law, some of the applicants for tax-exempt status under Section 501(c)(4) might have sought apology payments, and as a consequence, TAS may have been able to identify and address more quickly the problems that TIGTA discussed. Moreover, the IRS might be less likely to establish ineffective procedures and systems if they might trigger highly visible apology payments.

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

Congress no longer holds joint annual oversight hearings to review IRS challenges.

Closer congressional oversight could also be helpful. In the immediate aftermath of RRA 98, Congress for five years held an annual joint hearing to review the IRS's progress in meeting its objectives under its strategic and business plans, its progress in improving taxpayer service and compliance, and other issues.[95] Each hearing was conducted jointly by majority and minority members of the House Committees on Ways and Means, Appropriations, and Government Reform and Oversight and the Senate Committees on Finance, Appropriations, and Governmental Affairs. The hearings provided a useful vehicle for multiple committees of the Congress to review the IRS's progress and raise questions about potential problem areas.

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

95 Pub. L. No. 105-206, § 4001, 112 Stat. 685, 783 (1998). Note that the statute refers to a "joint review [to] be held at the call of the Chairman of the Joint Committee." The legislative history, however, makes clear that there was to be "one annual joint hearing" before June 1 of each of the succeeding 5 calendar years. H.R. Rep. No. 105-599, at 328 (1998) (Conf. Rep.).

C. Management and Administrative Failures

EO Determinations employees told TIGTA they developed the inappropriate case selection criteria "as a shorthand term for all potential political cases."[96] TIGTA found that this practice existed due in part to "insufficient oversight provided by management" and that even when management changed the BOLO criteria, there was no follow-up to ensure that Determinations Unit employees understood the changes and were able to apply them.[97] Determinations Unit employees, who had not been consulted about the new guidelines, reverted to using inappropriate criteria without management approval because they found the new guidelines "too lawyerly" to be useful.[98]

Affected organizations were burdened with extensive information requests, but EO made no attempt to provide outreach and education to them to explain what made their applications difficult to evaluate. These consequences are the natural outcome of unaddressed problems that have existed in TE/GE for years and only worsened over time, such as an increasing volume of IRC § 501(c)(4) cases accompanied by insufficient staffing (in terms of both outreach and education employees and Determinations Unit employees).[99] For example, in her 2009 Annual Report to Congress, the National Taxpayer Advocate reported that the informational and educational needs of 1.8 million diverse organizations were primarily supported by just nine IRS employees in the Exempt Organizations Customer Education and Outreach (CE&O) division of TE/GE.[100]

Management failed to install an adequate inventory management system.

EO does not have an adequate inventory management system. Its Employee Plans/Exempt Organizations Determination System (EDS) was supplemented in 2006 by the Tax Exempt Determination System (TEDS), an electronic system that contains case histories, but the hoped-for increases in efficiency did not materialize.[101]

As recently as 2011, EO did not appear to know how long it took, on average, to make a determination in response to a Form 1023 or Form 1024.[102] It did not maintain information about processing times, broken down between requests that can be disposed of at a screening stage and requests that require further development.[103] EO does not appear to routinely conduct reviews of aged cases to identify the reasons for the delay, perhaps because it does

96 TIGTA Report at 7.

97 TIGTA Report at 38.

98 TIGTA Report at 7.

99 TIGTA Report at 3. However, overall applications only started to increase in 2012. *Id.*

100 National Taxpayer Advocate 2009 Annual Report to Congress 287 (Most Serious Problem: *Targeted Research and Increased Collaboration Are Needed to Meet the Needs of Tax-Exempt Organizations*).

101 *See* National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*).

102 National Taxpayer Advocate 2011 Annual Report to Congress 442 (Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*).

103 IRS response to TAS information request (Aug. 26, 2011).

not have a system that identifies its oldest unresolved cases.[104] Thus, despite TAS warnings, EO management and leadership lacked basic tracking information that would help with early identification of inventory problems or delays attributable to employee confusion.

It appears that EO still lacks basic information needed to manage and plan its workload.[105] As described in the Areas of Focus section of this report, EO continues to struggle with processing and technology difficulties.

Recommendation: *EO should track the age and cycle time of all of its cases, including those referred to EO Technical, so that it can detect backlogs early in the process and conduct periodic reviews of over-aged cases to identify the cause of the delays.*[106]

Management failed to ensure requests for guidance received a timely response.

The recent TIGTA report found that "the Determinations Unit waited more than 20 months (from February 2010 to November 2011) to receive draft written guidance from the Technical Unit for processing potential political cases" and attributed some of the delay to changes in TE/GE management personnel.[107] TE/GE apparently had no system to ensure management followed up on requests for guidance or assistance that were not timely fulfilled. For context, TAS has several systems through which employees or members of the public can point out areas in which guidance is needed, and TAS keeps records of how submissions are addressed.[108]

Recommendation: *EO should track requests for guidance or assistance from the EO Technical Unit so that management can assess the timeliness and quality of the guidance and assistance it provides to both Determinations Unit employees and the public.*[109]

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104 *See generally* IRM 7.20.5 (July 7, 2009). TAS conducts reviews on cases unresolved after 100 days. TAS, FY 2013 Program Letter, Attachment 3, Philosophy of TAS Reviews 15 (Jan. 15, 2013).

105 TE/GE implies in its most recent work plan that it can produce detailed data about processing times. *See* IRS Exempt Organizations FY 2012 Annual Report and FY 2013 Workplan 14 (Jan. 2013) *available at* http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/EO-Implementing-Guidelines-and-Work-Plan ("The average wait time for full development applications at this time is roughly five months from the date we receive the application."). It also provides an estimate, on its website, that for those applications requiring development, it is currently assigning applications from April 2012 – 14 months after they were received. IRS, *Where Is My Exemption Application?*, http://www.irs.gov/Charities-&-Non-Profits/Where-Is-My-Exemption-Application (last visited June 18, 2013). EO recently confirmed to TAS that it does not have a good system for inventory management such as TAMIS. Minutes of June 4, 2013 conversation between Director, Tax-Exempt Organizations and TAS Executive Director of Systemic Advocacy (June 5, 2013).

106 As discussed above, a legislative change allowing judicial review of IRC § 501(c)(4) applications that remain unprocessed after 270 days would help provide accountability for delays.

107 TIGTA Report at 12.

108 Requests for guidance from a TAS technical advisor are recorded on the Taxpayer Advocate Management Information System (TAMIS). Another such TAS system, Case, Analysis, Procedural, Evaluative, Review (CAPER) allows TAS employees in the field to submit issues for which they need more general guidance. The submissions are referred to TAS's Technical Analysis and Guidance (TAG) unit, then stored on a database, tracked to identify trends and training opportunities, and elevated to TAS management as appropriate. TAS's Systemic Advocacy Management System (SAMS), available to employees and members of the public, operates in the same manner. TAS also maintains an "ASK THE NTA" mailbox that allows TAS employees to submit questions or comments that are then reviewed and addressed as appropriate.

109 As discussed below, TE/GE has tentatively agreed to track requests for guidance.

Management failed to mitigate the burden resulting from its automated exemption revocation process, multiplying exempt organization applications and straining EO resources.

On June 8, 2011, the IRS notified approximately 275,000 exempt organizations, most of which were public charities, that their tax-exempt status had been automatically revoked because they had not filed returns.[110] Judicial review of automatic revocations is not available, and the IRS did not provide an avenue for administrative review.[111] Adding to the burden on exempt organizations, TE/GE required those seeking reinstatement to submit a new application, a cumbersome process that also added to the IRS's inventory. Moreover, TE/GE did not appear to take the increased volume of (re)applications into account in planning or in allocating resources.

As the National Taxpayer Advocate reported in 2012, the "increased volume in applications for exempt status coincides with staff reductions, so that FY 2012 inventory is expected to be more than double the FY 2010 level, and applications that require assignment to a reviewer now take nine months to be assigned."[112] (According to IRS.gov, the time lag until case assignment now stands at 14 months.[113]) Many organizations were erroneously treated as no longer exempt. TE/GE generally receives about 60,000 applications for exemption each year, and more than 30,000 of the organizations whose status was automatically revoked reapplied for exemption, potentially increasing applications by half.[114] Moreover, the number of TAS cases with exempt organization issues increased more than fourfold from 2010 to 2012, an indication that the IRS's processes were causing significant hardship for many organizations.[115]

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

110 National Taxpayer Advocate 2011 Annual Report to Congress 437 (Status Update: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*). Section 1223 of the Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 automatically revokes the exemption of any organization (not only those exempt under IRC § 501(c)(3)) that has failed to file required returns or notices for three consecutive years.

111 Under IRC § 7428(b)(4), judicial review of automatic revocations is not available.

112 National Taxpayer Advocate 2012 Annual Report to Congress 192 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process are Burdening Tax-Exempt Organizations*). TE/GE open inventory applications increased from 15,570 cases in FY 2010 to 33,505 expected in FY 2012. *Id*. at 196.

113 As of June 21, 2013, the IRS website says: "Currently, we are assigning applications received in April 2012." *See* http://www.irs.gov/Charities-&-Non-Profits/Where-Is-My-Exemption-Application (last visited June 21, 2013).

114 IRS Exempt Organizations FY 2012 Annual Report and FY 2013 Workplan 13 (Jan. 2013) *available at* http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/EO-Implementing-Guidelines-and-Work-Plan (indicating that the IRS automatically revoked the exempt status of more than 450,000 organizations, and more than 30,000 of them submitted reinstatement applications). We say "potentially" because EO's figures do not purport to be exact.

115 National Taxpayer Advocate 2012 Annual Report to Congress 192, 193 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process are Burdening Tax-Exempt Organizations*). The increase in reinstatement cases would not have alerted TAS to the problems of inappropriate BOLO selection criteria and unnecessary information requests identified by TIGTA.

D. EO's Cultural Difficulty with TAS

EO executives resisted TAS's authority to order expedited processing of applications and isolated EO from TAS.

On or about March 28, 2007, the National Taxpayer Advocate met with the Director of EO and the Commissioner and Deputy Commissioner of TE/GE to discuss the "problem" of TAS's advocacy on behalf of organizations seeking IRC § 501(c)(3) status by issuing Taxpayer Assistance Orders (TAOs) requiring TE/GE to expedite its determinations on delayed applications.

By statute, the National Taxpayer Advocate and her delegates may issue a TAO when a taxpayer is suffering or is about to suffer a "significant hardship" as a result of the manner in which the IRS is administering the law.[116] Among other things, a significant hardship includes a delay of more than 30 days in excess of normal processing time and the incurring of significant costs, including costs for representation.[117] The Director of EO told the National Taxpayer Advocate that she had read the statute and that she believed it did not apply to EO, which had its own "expedite" criteria.

The Director of EO maintained that these "expedite" criteria specific to EO determinations cases, which are found in Revenue Procedure 2013-4,[118] and IRM 7.20.2.10, governed TAS EO cases—in effect, that the Director of EO had the sole discretion to determine what constituted a "significant hardship" for purposes of EO cases.[119] The National Taxpayer Advocate maintained that TAS's statutory authority to direct the IRS to act where a taxpayer is experiencing a significant hardship applied to EO cases, but the meeting ended without agreement. The attitude that EO does not have to be responsive to TAS permeated the organization and persists to this day, with one EO employee recently complaining about being "so tired of you [TAS case advocate] calling."[120]

Recommendation: *The National Taxpayer Advocate should provide training to EO employees about her authority under IRC § 7811 to order expedited processing of applications for exempt status and advocate for taxpayers.*[121]

116 IRC § 7811.

117 A "significant hardship" includes, but is not limited to: (1) an immediate threat of adverse action; (2) a delay of more than 30 days (beyond normal processing time) in resolving taxpayer account problems; (3) the incurring by the taxpayer of significant costs (including fees for professional representation) if relief is not granted; and (4) irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted. IRC § 7811(a)(2). Significant hardship also includes situations in which an IRS system or procedure fails to operate as intended or fails to resolve the taxpayer's problem or dispute with the IRS. Treas. Reg. § 301.7811–1(a)(4)(ii).

118 Rev. Proc. 2013-4, § 9.03(3), 2013-1 I.R.B. 126.

119 IRM 7.20.2.10(4) (Aug. 24, 2012) (allowing for expedited handling "when a factor outside an organization's control creates a real business need to obtain a letter ruling or determination letter before a certain time in order to avoid serious business consequences"). *See also* Rev. Proc. 2013-9, § 4.07, 2013-2 I.R.B. 255 (stating that circumstances generally warranting expedited processing include: "(1) a grant to the applicant is pending and the failure to secure the grant may have an adverse impact on the organization's ability to continue to operate; (2) the purpose of the newly created organization is to provide disaster relief to victims of emergencies such as flood and hurricane; and (3) there have been undue delays in issuing a determination letter or ruling caused by a Service error").

120 TAMIS case 5254727.

121 As noted below, we understand that TE/GE agrees with this recommendation.

TE/GE employees did not refer cases to TAS when appropriate, as required.

EO employees rarely refer cases to TAS. IRC § 7803(c)(2)(C)(ii) provides that the National Taxpayer Advocate shall "develop guidance to be distributed to all Internal Revenue Service officers and employees outlining the criteria for referral of taxpayer inquiries to local offices of taxpayer advocates." TAS typically works with each IRS operating division on IRM provisions, which direct employees to refer cases to TAS in appropriate circumstances. Accordingly, TE/GE phone assistors, like Wage & Investment Division (W&I) telephone assistors, are instructed to refer cases to TAS when the contact meets TAS criteria and the assistors are unable to resolve the case within 24 hours (or take steps within 24 hours toward resolving the case).[122] The IRM provisions the assistors consult cross-reference the IRM provisions that set out TAS criteria, including:

- Criteria 5: "The taxpayer has experienced a delay of more than 30 days to resolve a tax account problem;"
- Criteria 7: "A system or procedure has either failed to operate as intended or failed to resolve the taxpayer's problem or dispute within the IRS;" and
- Criteria 8: "The manner in which the tax laws are being administered raises considerations of equity or has impaired or will impair the taxpayer's rights."[123]

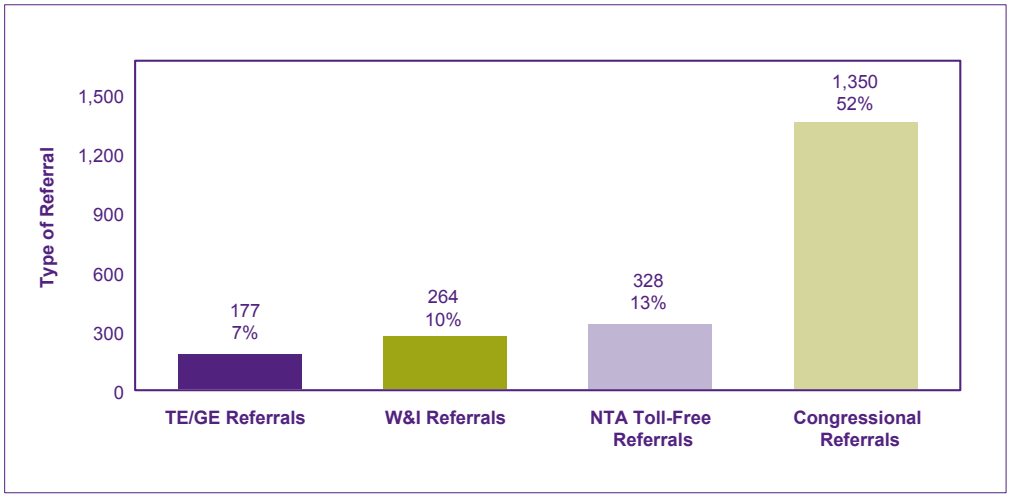
Thus, by not referring organizations to TAS when appropriate, EO employees violate their own guidance. For FY 2011 and 2012 combined, as shown by Figure I below, most TAS receipts with EO issues were Congressional referrals. Of the 2,576 TAS case receipts with EO issues for that period, only 177 (or seven percent) were referred by TE/GE, while 264 were referred by W&I telephone assistors, 328 were referred by the National Taxpayer Advocate toll-free line assistors (*i.e.,* W&I employees), and 1,350 were referred by Congressional offices.[124]

122 IRM 21.3.8.8.6 (Oct. 1, 2009).

123 IRM 13.1.7.2.2 (July 23, 2007).

124 The remaining cases came from other sources. As TAS received 515,570 cases in FY 2011 and FY 2012, 2,576 EO cases represent less than one percent of the total, and many of these were IRC § 501(c)(3) reinstatement cases, as noted above. *TAS Business Performance Review*, FY 2013, 1st Qtr., 3 (FY 2012).

FIGURE I: SOURCE OF TAS RECEIPTS WITH EO ISSUES, FY 2011 AND 2012 COMBINED



The EO function has a goal of processing applications in 121 days.[125] As of December 2012, all of the 160 potential political cases identified by TIGTA had been open for more than 151 days (the normal processing time of 121 days plus 30 days), and more than 80 percent had been open for more than a year.[126] *Thus, all of these organizations were eligible for assistance from TAS under Criteria 5.* Yet, as discussed below, none of them were referred to TAS by EO.

> **Recommendation:** *TAS and the National Taxpayer Advocate should provide guidance and training to EO employees about when to refer cases to TAS.*[127]

EO's failure to refer IRC § 501(c)(4) cases eligible for TAS assistance or report a systemic problem undermined TAS's ability to identify a continuing systemic problem.

Neither EO employees nor any member of the public referred the systemic issues that TIGTA uncovered to TAS's Systemic Advocacy function or its Systemic Advocacy Management System (SAMS).[128] SAMS is the system that TAS uses to identify systemic problems in the IRS. Both IRS employees and the public can notify us of systemic problems on SAMS via the IRS intranet and the Internet, respectively. Had EO employees posted their concerns about not receiving timely guidance for handling IRC § 501(c)(4) applications, TAS would have followed its regular procedure of preliminarily investigating

125 TIGTA Report at 12 n.30.

126 TIGTA Report at 15 (Figure 6). Applicants for exemption under IRC § 501(c)(3) are generally authorized to file suit to force a decision on their applications if the IRS does not approve or deny them within 270 days. IRC § 7428(b)(2); Rev. Proc. 2013-9, § 10.03, 2013-2 I.R.B. 255. As of May 31, 2012, 32 (36 percent) of the 89 IRC § 501(c)(3) "potential political" cases identified by TIGTA were open more than 270 calendar days. TIGTA Report at 16.

127 TE/GE has already agreed with this recommendation.

128 TAS searched SAMS submissions for the period January 2010 through November 2012.

the concern and looking into its own inventory of cases. This preliminary investigation would most likely have uncovered the significant delays and confusion in processing these applications.

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

A search of TAS databases containing over 915,000 case receipts identified 19 cases that may have been affected by the BOLO selection criteria.

Following the release of the TIGTA report, TAS searched its databases for the period January 1, 2010, through May 17, 2013, and identified 19 cases that may have involved the BOLO selection criteria out of over 915,000 total receipts during that period.[129] The 19 cases were received by ten different TAS offices in nine different states, with the first case received in May of 2010 and the last case in April of 2012. Most of the TAS cases (15 out of 19) were referred by Congressional offices (*i.e.*, the taxpayer contacted a member of Congress, who then contacted TAS on behalf of the taxpayer).[130] In these cases, TAS does not respond to taxpayers directly without the permission of the Congressional office and works closely with the Congressional office to develop the case and determine the appropriate time to close it.[131]

While many TAS EO cases are worked in the TAS Cincinnati office because of its proximity to the IRS office that processes applications, EO cases referred by Congressional offices are worked in the local TAS office aligned with the Congressional district or state.[132] Of the 19 cases TAS received, six were handled in the TAS Cincinnati office, three were handled in one other office, and the remaining cases were scattered among TAS offices in different states over the 23-month period from May 2010 to April 2012.[133]

None of the 19 organizations were issued letters denying them recognition of exempt status. The IRS granted exempt status to more than half of the organizations assisted by TAS (11 of the 19), with two obtaining recognition between April and September of 2011.[134]

129 TAS identified these 19 cases by systemically searching the Taxpayer Advocate Management Information System (TAMIS) database, a web-based inventory control and reporting system used to control and track TAS cases and provide management information. *See* IRM 13.4.1.1 (Jan. 15, 2005). TAS searched all cases in which the organization was identified with the code TE/GE and the issue was coded as involving an application for exempt status, and all cases coded as TE/GE (EP/EO) Technical cases. TAS then conducted keyword searches of all TAMIS fields of these extracted cases, including the history narrative and the Business Name Field. The words searched were those found in the TIGTA report and press releases (such as Tea Party, Patriot, 9/12, Liberty, Educate, Constitution, and Conservative) and additional terms developed from reading cases. In all, TAS searched more than 40 terms or phrases. TAS manually reviewed 88 cases it identified using these searches. TAS also carried out additional searches and manual reviews of cases on other lists, such as the list of cases referred to TAS by Congressional offices. Not all of the 19 TAS cases were applications for exemption.

130 *See* IRM 13.1.8.4.1 (Apr. 26, 2011).

131 IRM 13.1.8.4.1 (Apr. 26, 2011).

132 In order to foster communication between local TAS offices and exempt organizations in the same community, going forward TAS will work all EO cases (not only Congressional referrals) in the TAS office where the organization is located.

133 Of the 19 TAS cases, two were received in 2010 in two different offices; 11 were received in 2011 in seven different offices; and six were received in 2012 in six different offices.

134 Some cases had received exempt status prior to contacting TAS and some cases received exempt status after TAS closed its case.

Three organizations withdrew their applications.[135] Of the remaining five cases, three were closed by the IRS because the applicant did not respond to requests for additional information, and two cases are still open in TE/GE and assigned to a reviewer.

One TAS office received three cases and elevated the issue.

From February 2011 to February 2012, a single TAS office received three cases from organizations seeking assistance with delays in processing their requests for exempt status under IRC § 501(c)(3) or (c)(4).[136] In each of these cases, the case advocate received an email from EO that purported to explain the delay with the following identical language:

- "When we get many applications with the same novel issues, we attempt to develop a template approach to identify the issues and the best methods to process the applications;"
- "Since novel issues usually are complex, EO Technical and our office usually consult other offices within the Service to get their technical input. This process takes time;" and
- "This is one of many applications (at least [a number between 125 and 170 was inserted here, depending on the letter] applications) with the same novel issues, and we are working with EO Technical to come up with a template approach to process them. Currently, we are not finished with developing a template approach."

In consultation with the congressional office, TAS closed the first case because it was unable to accelerate the application process, but remained available for additional assistance if the taxpayer or the congressional office needed it. In December 2011, after the same TAS office received the second case in which EO offered the identical explanation for the delay as in the first case, TAS asked TE/GE "What are the 'same novel issues' raised by both [these cases] and 168 other organizations?"[137] No explanation was provided. Thereafter, in a conversation with an EO Revenue Agent (RA), a TAS analyst reported that he

> "asked [the RA] a few questions, none of which she would answer. In particular, I asked her what this group of TPs [taxpayers] had in common and what were the 'same novel issues.' She said someone in EO is about to issue some guidance, but wouldn't say more, other than she'd check with her manager and call [the case advocate] back today. I didn't get to talk to the RA when she called today. [The case advocate] told me her message was that they're not going to tell us anything."

135 One of the organizations has since returned to TAS, and we are assisting in getting the application processed. TAS will attempt to contact the other organizations to determine whether they would like to reopen their cases.

136 TAMIS cases 4978504, 5208078, and 5242438.

137 TAMIS case 5208078 (case history notes).

Confronted with the EO employee's unwillingness to provide an explanation, the TAS analyst elevated his concerns to TAS's National Office in February 2012.[138] In February 2012, the TAS National Office contacted the Director of EO and the Director, EO Rulings and Agreements, to inquire about the processing delays. These EO executives said the applications raised concerns that the organizations might be engaging in political or other non-exempt activities, and that the cases were being held pending National Office guidance.

In March 2012, the Director of EO and the Director, EO Rulings and Agreements, informed TAS's National Office that it had created a "development letter" that would allow the Determinations Unit to process the applications. The National Taxpayer Advocate's staff shared this information with the Local Taxpayer Advocate's office, which continued to work on the cases. The cases began to move in late Spring 2012, and the organizations with cases open in this Local Taxpayer Advocate's office were granted exempt status during the Summer of 2012.

None of the six cases received in the TAS Cincinnati office appeared to involve a pattern of inappropriate selection criteria.

Six of the 19 cases TAS identified as having potentially been affected by inappropriate selection criteria were handled in the TAS Cincinnati office. None of the cases involved a taxpayer with "Tea Party" in its name, and TAS did not receive an email in any of those cases like the one described above that referred to the "same novel issues."

In one case, EO told the case advocate the reason for the processing delay was that EO was "waiting on guidance from EO Tech. [The organization] has some possible political ties [Tea Party]."[139] In another case, EO explained that "EO is waiting for technical guidance from national office on these cases [tea party-PAC]."[140] In a third case, involving an application for recognition under IRC § 501(c)(3) by an entity whose progressive-sounding name did not contain any of the terms mentioned in the TIGTA report, EO advised that the application was "taking so long due to the name."[141] A fourth case did not contain any of these explanations; EO asked the taxpayer extensive questions, and the taxpayer withdrew the application.[142] A fifth case appeared to involve an unrelated tax issue.[143] The sixth case involved an organization already exempt under IRC § 501(c)(4).[144]

While TAS advocated for the 19 organizations whose cases were referred and the TAS National Office raised concerns about processing delays with the EO Director, it is possible that if TAS employees had received more in-depth training about the law of exempt

138 The same office then received the third case.

139 TAMIS case 5191983.

140 TAMIS case 5210082.

141 TAMIS case 5254727.

142 TAMIS case 5204380.

143 TAMIS case 4947752.

144 TAMIS case 4879401.

organizations, a problem beyond mere processing delays might have been identified. Had they recognized the complex issues involved, they might have requested assistance from a TAS technical advisor or elevated the issue to TAS's National Office earlier. Moreover, had they not been confronted with TE/GE's misleading responses and EO's erroneous stance on the issue of expedite criteria, they might have issued TAOs. Thus, in addition to making broader systemic recommendations, TAS plans to make internal improvements to ensure better issue identification in the future.

TAS will improve its ability to serve the EO community and identify systemic issues.

Faced with an average of more than 270,000 case receipts each year, it is difficult for TAS to identify all systemic issues that arise from its casework. It is particularly difficult to identify those systemic issues that affect relatively small groups of taxpayers – especially where, as here, the issues are spread among offices throughout the country and there is no precise issue code by which the cases are tracked.[145] But we believe the internal improvements we plan to make, coupled with the broader recommendations we propose, will substantially increase the odds of flagging issues such as this in the future. TAS will take the following steps to improve its ability to assist the EO community and identify systemic issues:

- TAS will train TAS case advocates on EO law, when to elevate issues to a TAS technical advisor or the National Taxpayer Advocate's office, when to recommend issuing a TAO, and when and how to refer systemic issues to TAS's Systemic Advocacy function.
- TAS will provide more advanced training on EO law to technical advisors and higher-graded TAS case advocates so they are better able to identify overly broad IRS inquiries.
- TAS will hire one or two additional TAS technical advisors with EO expertise to assist on individual TAS cases and work to solve systemic problems.
- TAS will participate in a task force with TE/GE to identify and address systemic issues, and designate a liaison to work with the Cincinnati EO office.
- TAS will assist TE/GE to implement the recommendations in this report.

E. Update: TAS and TE/GE are now working together to address EO management issues and reduce taxpayer burden.

TE/GE executives have proposed a task force with TAS to focus on EO procedures, update the TAS-TE/GE Service Level Agreement as necessary, and identify training and education

145 *TAS Business Performance Review*, FY 2013, 1st Qtr, 3 (FY 2012). When TAS case advocates receive a case, they assign Primary and (one or more) Secondary Issue Codes, indicating what issues are involved and, by inference, what functions TAS must work with to resolve all issues completely before closing the case. IRM 13.4.5, *TAS TAMIS Guide* (Jan 11, 2012) lists over 100 different issue codes. As noted above, TAS was aware that it had received an increase in EO cases from small organizations requiring reinstatement after having their exempt status automatically revoked for failing to file a return. It was actively working those cases and the related systemic issue, including identification of this issue as a "most serious problem" for taxpayers in several National Taxpayer Advocate Annual Reports to Congress.

issues for employees.[146] The task force is to meet every month. TE/GE has agreed to issue guidance to EO staff about TAS's role and will arrange a time for the National Taxpayer Advocate to visit the Cincinnati EO office to train EO employees on TAS case criteria, when to refer cases to TAS, how to submit issues on SAMS, and about TAS's statutory authority to issue TAOs. The training will be recorded and shown to new TE/GE employees.

In addition, TE/GE intends to develop a formal process for initiating, tracking, and monitoring requests for assistance, using the existing system to minimize costs, and has accepted TAS's offer to assist with this endeavor. TAS will also help TE/GE develop standards for follow-up contacts and correspondence with the public based on TAS's case-quality standards.

As an illustrative example, TAS measures whether TAS employees timely and accurately update all case activity on the Taxpayer Advocate Management Information System (TAMIS), TAS's electronic case management system.[147] It is important for this system to include all case activity so that different employees can view all the relevant activity related to the case. In contrast, not all EO cases are established or worked using TEDS, and a TEDS User Manual is still under development.[148] EO also uses IRS Form 5464-A, *EP/EO Case Chronology Record*, to record case history and this record may exist in hard copy only.[149]

As TAS provides training and new procedures to its own employees, TAS will designate additional staff to monitor the status of TAS EO cases to ensure that TAS is addressing underlying issues, seeking technical assistance where necessary, and elevating issues as appropriate. As part of its monitoring, TAS will seek read-only access to TEDS as well as access to other records that describe EO case developments.

Moreover, TE/GE executives have informally agreed to reopen applications, without collecting a second application fee, from organizations inappropriately selected for review as described by TIGTA that withdrew their applications and now wish to be considered for exempt status. Finally, TE/GE agreed to work with the National Taxpayer Advocate to develop procedures for identifying organizations inappropriately selected for review that have not requested that their cases be reopened.

146 The TAS/TE/GE Service Level Agreement outlines the procedures and responsibilities for the processing of TAS casework when the authority to complete case transactions (such as making a determination about exempt status) rests outside of TAS. Service Level Agreement Between the National Taxpayer Advocate and the Commissioner, Tax-Exempt/Government Entities § VIII (May 29, 2009), http://www.irs.gov/file_source/pub/foia/ig/tas/sla_tas_tege_2009-05-29.pdf.

147 *See* IRM Exhibit 13.2.2-10, Attributes T9, A1, A4 (July 16, 2009).

148 IRM 7.20.2.1 (Aug. 24, 2012).

149 IRM 7.20.2.13 (Aug. 24, 2012).

VI. Conclusion

Since the release of the TIGTA report on EO processing problems, TAS has examined the problems identified. TAS found that inadequate guidance, inadequate training, inadequate systems, inadequate metrics, insufficient transparency, and management failures all contributed to the problems, along with EO's failure to vet its guidance with TAS and EO leadership's failure to acknowledge TAS's statutory authority, or to instruct EO employees to refer cases to TAS. The National Taxpayer Advocate has offered preliminary recommendations (listed above) to help prevent these and similar problems from recurring, and also plans to implement internal reforms. The National Taxpayer Advocate will study these issues more closely during the remainder of 2013 and anticipates developing some of these recommendations further in her year-end report to Congress.

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