

**MSP
#21****EXEMPT ORGANIZATIONS (EOs): The IRS's Delay in Updating Publicly Available Lists of EOs Harms Reinstated Organizations and Misleads Taxpayers****RESPONSIBLE OFFICIAL**

Sunita B. Lough, Commissioner, Tax Exempt and Government Entities Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*

DEFINITION OF PROBLEM

The IRS maintains a list of tax exempt organizations (EOs) on two publicly accessible online databases, the Exempt Organizations Business Master File (EO BMF)² and the Exempt Organizations Select Check (EO Select Check).³ When an organization fails to file an information return or notice for three consecutive years, its exempt status is automatically revoked.⁴ Shortly after this automatic revocation, which can sometimes be erroneous, the IRS removes the EO from its online-published lists of EOs and lists it as one whose exempt status was automatically revoked.

Unless the automatic revocation was due to IRS error, an automatically revoked organization must submit a new application to have its exempt status reinstated.⁵ Even if the IRS promptly reinstates the organization or discovers its error, IRS databases will not immediately reflect the organization's restored exempt status. The IRS updates its databases only monthly, on the second Monday of every month, except in January when the databases are not updated at all. As a result, EOs reinstated (as well as those that receive initial exemption approval) in mid-to-late December will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising season. Reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status. The number of automatic revocation reinstatement cases during this gap period exceeded 2,500

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The EO BMF, *available at* <http://www.irs.gov/Charities-&Non-Profits/Exempt-Organizations-Business-Master-File-Extract-EO-BMF>, contains information about EOs such as the organization's employer identification number (EIN), name and address, the Internal Revenue Code (IRC) § 501(c) subsection under which it is exempt, whether contributions to it are tax deductible, whether it is a private foundation or a public charity (and the type of public charity), the month and year it received its exemption ruling, and information from its Form 990 series return. See Exempt Organizations Business Master File Extract (EO BMF), *available at* http://www.irs.gov/pub/irs-soi/eo_info.pdf.

3 EO Select Check is an online search tool, *available at* <http://apps.irs.gov/app/eos/>, that allows users to search for organizations eligible to receive tax deductible contributions (Publication 78 data), organizations whose tax exemption has been automatically revoked for not filing a Form 990-series return or notice for three consecutive years (Auto-Revocation List), and organizations that have filed a Form 990-N (also called an e-Postcard), an annual notice required to be filed by small EOs. Unless otherwise indicated, we use "EO Select Check" to refer to the capability to determine whether an organization is eligible to receive tax deductible contributions (Publication 78 data). See Internal Revenue Manual (IRM) 25.7.6.1, *Overview* (Jan. 1, 2015).

4 See IRC § 6033(j)(1) (requiring the IRS to publish and maintain a list of automatically revoked organizations).

5 See IRC § 6033(j)(2).

in both fiscal years (FYs) 2014 and 2015, and more than 70 percent of these cases were IRC § 501(c)(3) organizations.⁶

ANALYSIS OF PROBLEM

Background

Potential Donors and Grantors Rely on IRS Online Databases to Verify Exempt Status

The National Taxpayer Advocate has repeatedly raised concerns about IRS delays in updating its public databases relied upon by potential donors and grantors.⁷ These databases, EO BMF and EO Select Check, are of critical importance for two reasons. First, they allow potential individual donors to verify before making a donation that their contributions will be tax deductible.⁸ Second, they allow private foundations to verify that they are making a grant to a qualifying public charity.⁹

As a result, Exempt Organizations (EOs) reinstated (as well as those that receive initial exemption approval) in mid-to-late December will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising season. Reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status.

IRS guidance provides that grantors and contributors may rely on an organization's listing on EO Select Check or EO BMF.¹⁰ In addition, grantors and contributors may, in some situations, rely on EO BMF information provided by a third party.¹¹

One well-known third-party provider of EO Select Check and EO BMF data is GuideStar.¹² GuideStar's website contains free and subscription content. One feature available to GuideStar subscribers is Charity Check, which allows potential donors or grantors to conduct due diligence by obtaining a report that contains both EO Select Check and EO BMF data.¹³ The report will also note if an organization has been automatically revoked.¹⁴

In FAQs on its website regarding due diligence and its Charity Check reports, GuideStar makes clear that it does not modify any IRS data, including data from EO Select Check, EO BMF, or the automatic revocation list.¹⁵ In one FAQ regarding potential grantees whose organization does not appear in the EO BMF section of the Charity Check report,

6 TE/GE response to TAS research request (July 31, 2015).

7 See National Taxpayer Advocate FY 2015 Objectives Report to Congress 59; National Taxpayer Advocate 2012 Annual Report to Congress 199-200 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*).

8 A charitable contribution deduction is allowed for donations to organizations described in IRC § 170(c). These are most commonly IRC § 501(c)(3) organizations.

9 Private foundations prefer making grants to qualifying IRC § 501(c)(3) public charities over other organizations as doing so relieves them of certain oversight requirements (called expenditure responsibility) that would otherwise arise and eliminates the risk of incurring liability for an excise tax under IRC § 4945.

10 See Rev. Proc. 2011-33, 2011-25 I.R.B. 887.

11 *Id.*

12 See www.guidestar.org. GuideStar is an IRC § 501(c)(3) public charity that provides information and reports about nonprofit organizations registered with the IRS.

13 For a sample Charity Check report, see <http://www.guidestar.org/downloadable-files/sample-guidestar-charity-check-report.pdf>.

14 See FAQs: *Due Diligence and GuideStar Charity Check Overview*, FAQ #15, available at <http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx>.

15 See FAQs: *Due Diligence and GuideStar Charity Check Overview*, FAQs #16 and #17, available at <http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx>.

GuideStar advises these organizations to “work directly with the IRS to ensure that their information is updated and accurately reflected in the IRS database.”¹⁶ Understandably, GuideStar emphasizes that it “cannot and will not modify the IRS BMF database in any way” and directs these organizations to contact the IRS EO toll-free number.¹⁷ Thus, GuideStar (or any third-party) data is only as good as the source data from the IRS’s online databases.

Other organizations highlight the importance of the EO Select Check and EO BMF databases to potential donors and grantors that are conducting due diligence and vetting organizations. For example, the Council on Foundations, a nonprofit leadership association of grantmaking foundations and corporations, has information on its website advising grantmakers of the EO Select Check search tool and referencing the EO BMF.¹⁸ Another organization, Grants Managers Network, advises grantors that are conducting due diligence and vetting potential grantees that “the best practice, if you have doubts about a potential grantee’s tax status, is to check it online using the IRS’s free Exempt Organizations search or a third-party source.”¹⁹

Finally, a grantmaking foundation may require potential grantees to be listed on the EO BMF. For example, one private foundation’s website explains in great detail the nature of the EO BMF and requires potential grantees to have an accurate EO BMF listing.²⁰

The IRS Recognizes the Reliance of the Public and Potential Grantors on Its Online Databases Yet It Fails to Update Them Timely

The IRS Recognizes Reliance on the Information Contained in Its Online Databases

The Internal Revenue Manual (IRM) discussing EO Select Check notes:

The exempt organization (EO) community has become increasingly dependent upon their listings in the CL [EO Select Check] to prove to potential contributors that contributions to them are deductible. The fact that an organization may hold a favorable determination letter is often not sufficient to satisfy some contributors, especially in those cases where the Service issued an organization’s letter many years ago.²¹

Similarly, a Tax Exempt/Government Entities (TE/GE) IRM section discussing the EO BMF notes that “many grantors rely on the information contained in the online EO BMF to determine the eligibility of

16 See *FAQs: Due Diligence and GuideStar Charity Check Overview*, FAQ #17, available at <http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx>.

17 *Id.* This number is 877-829-5500.

18 See Council on Foundations, *IRS Search Tool: Select Check*, available at <http://www.cof.org/content/irs-search-tool-select-check>.

19 See *Project Streamline: Guide to Due Diligence*, p. 6, available at <http://gmnetwork.org/wp-content/uploads/2014/07/Due-Diligence.pdf>. This document discusses five myths about due diligence. Myth #3 is that grantmakers need to have a copy of a grant seeker’s IRS determination letter and Form 990 in every file. The document provides that a copy of the IRS determination letter only indicates that the grantee was tax-exempt at a certain point in time and the original determination may have been rescinded or modified. Therefore, grantors should verify a potential grantee’s tax status online with the IRS or a third-party source. Grants Managers Network is a national association of philanthropy professionals.

20 See Mathile Family Foundation, *FAQs – Tax Information*, available at <http://www.mathilefamilyfoundation.org/grantmaking/faqs/tax-information/>. These FAQs discuss in great detail the grantmaking restrictions on private foundations and the severe penalties that the foundation and its managers are subject to if these rules are violated. The FAQs also advise potential grantees to “**make sure that the IRS BMF code currently represents your non-profit activities/operation (Form 990) and aligns with your Form 1023 filings and subsequent communications as approved by the IRS. When these separate designations do not agree, your organization is required to rectify discrepancies with IRS. Please consult with your tax advisor.**” (bold and italic emphasis in original).

21 IRM 25.7.6.1(3) (Jan. 1, 2015). The same language is also used in IRM 21.3.8.12.12(3) (June 18, 2012).

their applicants.”²² Yet in the same IRM section the IRS disavows responsibility if an organization loses a grant due to not being included in the EO BMF, noting:

The IRS cannot control how grantors and contributors use these data. It is not Service error if an organization fails to receive a grant because it is not included in the online EO [B]MF, or because some of the information contained therein is out-of-date. Possession of a valid determination letter is the ultimate legal proof of tax-exempt status.²³

Despite Recognition of the Reliance on Its Online Databases, the IRS Fails to Timely Update Them, Causing Harm to EOs and Their Contributors

Although the IRS recognizes that a listing on its online databases can be critical for an EO, it does not update these databases in a timely manner, causing reinstated automatically revoked organizations (as well as those organizations receiving exempt status for the first time) to potentially lose out on donations or grants.²⁴ Currently, EO Select Check and EO BMF are only updated monthly, on the second Monday of every month.²⁵ An organization that misses the updating cutoff will not appear on the IRS lists until the next month. In addition, these databases are not updated at all during the month of January, meaning there is a two-month updating gap from the second Monday in December until the second Monday in February.²⁶ As a result, new and reinstated EOs that receive IRS approval of exemption after the early December cutoff will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising push. The number of automatic revocation reinstatement cases during this gap period ranged from 1,353 to 2,792 in FYs 2012 to 2015, exceeding 2,500 in both FYs 2014 and 2015, as shown in Figure 1.21.1. Significantly, more than 70 percent of these cases from the last two fiscal years are IRC § 501(c)(3) organizations.

22 IRM 21.3.8.12.13(3) (Nov. 16, 2012).

23 *Id.*

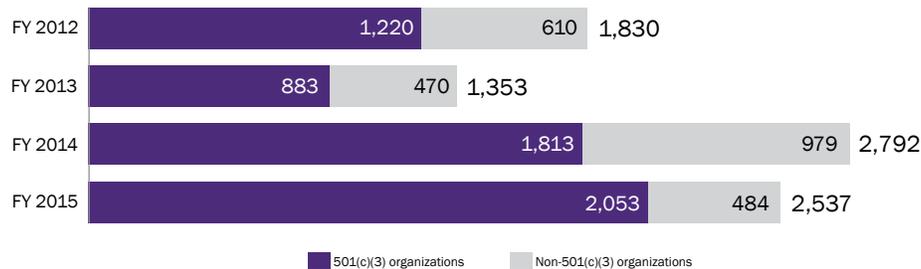
24 This delay may also affect newly-recognized tax EOs that receive a determination letter but are not promptly listed on the online databases. However, the harm to reinstated automatically revoked organizations is arguably greater as these organizations were formerly tax exempt and had the ability to receive tax-deductible contributions.

25 IRM 21.3.8.3.8(1)(f) (Oct. 1, 2015) (noting “online Publication 78 data is generally updated the second Monday of each month”); IRM 21.3.8.12.13(2) (Nov. 16, 2012) (noting that EO BMF is updated or extracted monthly). The term “extracted” is used because, as mentioned earlier, the EO BMF is an extract of information regarding EO accounts from the larger Business Master File (BMF). See IRM 25.7.5.1(1) (Jan. 1, 2015). In response to a TAS information request, the IRS stated that the internal IRS EO BMF list is generally updated within two weeks of a favorable case closing. The IRS also stated that the program that produces the online EO BMF and EO Select Check extracts is run approximately the last full week of each month and posted online to irs.gov the second Monday of the following month. Any accounts that are updated and posted prior to the running of the extract program will appear online. This means that an EO account update could take between 30 to 60 days to be reflected on the online EO BMF and EO Select Check databases. TE/GE response to TAS research request (July 31, 2015). Thus, there is a disconnect between IRS internal database updating (approximately two weeks) and external (*i.e.*, online) database updating (30-60 days).

26 See IRM 25.7.5.1(1) (Jan. 1, 2015) (noting that the EO Standard Extract Program is a computer program that is run on a monthly basis (except for January) to allow for extraction of both entity and limited return information from EO accounts contained on the BMF).

FIGURE 1.21.1²⁷

Automatic Revocation Reinstatement Cases, December-February



This potential month or two delay also impairs an EO's *right to quality service*, which includes taxpayers' right to receive prompt assistance in their dealings with the IRS.

The IRS's Suggestions for Those Impacted By the Updating Delay Miss the Mark

The IRS website notes that an automatically revoked organization that has had its exempt status reinstated will experience a delay from the time of reinstatement until EO Select Check and EO BMF are updated.²⁸ The IRS website explains the reason for this delay and advises the following to reinstated organizations who are not yet listed:

Between updates to Select Check (Pub. 78 Data) and EO BMF, donors can rely on your organization's determination letter from the IRS as proof of your exempt status. Even if your organization remains on the list of automatically revoked organizations, donors can rely on an IRS determination letter dated on or after the effective revocation date. Donors also can confirm an organization's status by calling the IRS (toll-free) at 1-877-829-5500.²⁹

However, the IRS's advice that donors can rely on an IRS determination letter or call the IRS for confirmation of an organization's status belies the IRS's own recognition that donors, particularly large donors and corporate or foundation grantors, often look *solely* to the IRS online databases to determine whether or not to make a donation or grant to an organization. A determination letter from the IRS (and, by extension, a phone call to the IRS) will in many cases not satisfy a potential donor or grantor. Many donors or grantors may simply "move on" and make a donation or grant to an organization that does appear on EO Select Check and EO BMF.

Further, the IRS's failure to timely update its online databases places the onus for proving exemption on the organization and causes a burden for potential grantors or donors to have to contact an organization and ask for a determination letter or contact the IRS and deal with lengthy telephone hold times, on a general TE/GE phone line that is not dedicated specifically to EO matters, to request confirmation

²⁷ TE/GE response to TAS research request (July 31, 2015).

²⁸ See IRS, *Exempt Organizations Select Check: Timing of Database Updates for Organizations Whose Exempt Status Is Reinstated*, available at <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check:-Timing-of-Database-Updates-for-Organizations-Whose-Exempt-Status-Is-Reinstated>.

²⁹ *Id.*

In fact, the IRS has stated that its future efficiency lies in providing taxpayers with “self-service” electronic options; thus, Tax Exempt and Government Entity’s (TE/GE) strategy to drive grantors and donors to the phone for Exempt Organization (EO) verification is out of step with the IRS’s own Concept of Operations.

of exempt status.³⁰ In FY 2015, callers to the TE/GE toll-free line waited an average of 23.4 minutes to speak to an IRS representative, an increase of almost five minutes from the 18.7 minute average hold time in FY 2014.³¹ In addition, the number of IRS “courtesy disconnects” for the TE/GE phone line increased dramatically, from 4,380 in FY 2014 to 23,871 in FY 2015, a 445 percent jump.³² Finally, the IRS customer service representative (CSR) level of service for this phone line dropped from 68 percent in FY 2014 to 60 percent in FY 2015.³³ As the IRS is expected to experience continued budget and hiring constraints, TE/GE telephone hold times and courtesy disconnects will likely continue to increase and the CSR level of service will likely continue to decrease. In fact, the IRS has stated that its future efficiency lies in providing taxpayers with “self-service” electronic options; thus, TE/GE’s strategy to drive grantors and donors to the phone for EO verification is out of step with the IRS’s own Concept of Operations.³⁴

Finally, the IRS’s delay in updating its online databases undermines the public’s (*i.e.*, potential donors or grantors) *right to be informed*, which includes taxpayers’ right to know what they need to do to comply with the tax laws. The IRS’s delay prevents the public from finding out about certain organizations that are tax exempt and eligible to receive tax deductible contributions.

This problem is magnified for an organization that has had its exemption automatically revoked in error, as the organization should never have been removed from the IRS’s online lists and now may face a significant delay getting back on them, thereby hampering its fundraising efforts.³⁵ In sum, the failure to

30 In addition, a reinstated automatically revoked organization may be reluctant to show its new determination letter to potential donors or grantors as it draws attention to the fact that the organization was automatically revoked.

31 IRS, Joint Operations Center (JOC), *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015).

32 IRS, *Custom Joint Operations Center Report* (Oct. 30, 2015). The term “courtesy disconnect” is used when the IRS essentially hangs up on a taxpayer because its switchboard is overloaded and cannot handle additional calls.

33 *Id.* IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015).

34 See Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive “Future State” Plan That Aims to Transform the Way It Interacts with Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*, *supra*; Most Serious Problem: *Taxpayer Access To Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues that Are Not Conducive to Resolution Online*, *supra*. In describing the future vision of the IRS, IRS Commissioner John Koskinen stated, “Most things that taxpayers need to do to fulfill their obligations could be done virtually, and there would be much less need for in-person help, either by waiting in line at an IRS assistance center or calling the IRS.” *Prepared Remarks of John A. Koskinen, Commissioner, Internal Revenue Service, Before the National Press Club* (Mar. 31, 2015), available at <https://www.irs.gov/uac/Newsroom/Commissioner-Koskinen-Speech-before-the-National-Press-Club>.

35 The IRS states that “erroneous revocations are identified through taxpayer correspondence and referrals from the call-site.” TE/GE response to TAS research request (July 31, 2015). In other words, the onus is on the erroneously automatically revoked organization to contact the IRS to correct the issue. Once the IRS is contacted about an erroneous automatic revocation, the Employee Plans/Exempt Organizations (EP/EO) Determinations Processing Unit (“Correspondence”) will conduct research to determine if the revocation was indeed erroneous. The Correspondence Unit will then send the organization a letter affirming that it was erroneously revoked or that the revocation was correct. If the organization was erroneously revoked, the Correspondence Unit places the name of the organization on a spreadsheet, which it sends weekly to Ogden to remove the organizations listed from the EO Select Check list of automatically revoked organizations. The IRS indicates that these correspondence inquiries are typically completed in 30-45 days. TE/GE response to TAS research request (July 31, 2015). Regarding the reinstatement process for organizations that were erroneously automatically revoked, the IRS states that it generally does not request manual updates to EO Select Check data unless it identifies an organization (for example, through an inquiry) that should be listed but for some reason is not picked up by the automated updating process. If the IRS does not do a manual update, then the organization must go through the normal monthly updating process for both EO Select Check and EO BMF after an internal record correction is made. TE/GE response to TAS research request (Dec. 1, 2015).

list a reinstated automatically revoked organization in its online databases in a timely manner can cause an organization to lose critical donations or grants, which may be an existential issue for some organizations.

The IRS also acknowledges these delays in its TE/GE IRM. For example, the IRS instructs its employees who are responding to a telephone call regarding an organization's omission from the EO BMF to "advise the customer that due to a systemic problem, the online 'lists' were not updated to reflect the exempt [sic] recognition."³⁶ The IRS also instructs its employees to advise organizations that it can take up to two months for a record of an organization's exempt status to be reflected on the online list and to offer to send an affirmation letter to the organization.³⁷ However, an affirmation letter is similar to a determination letter, and may not be sufficient to satisfy potential donors or grantors that rely solely on the IRS's online databases.

More Frequent Updates to EO Online Databases Are a Simple Solution

The IRS's delay in updating the online lists of Exempt Organizations (EOs) that are relied upon by both individuals and organizations harms reinstated organizations and misleads taxpayers, thereby abridging core taxpayer rights. This problem can be significantly mitigated if the IRS updates these lists more frequently.

The solution to this problem is simple — the IRS must update its online databases of EOs more frequently. The monthly updating (except for January) of EO Select Check is a great improvement over the quarterly updating of the old Publication 78 and the IRS is to be commended for this. However, more frequent updating of EO Select Check and EO BMF is now needed. The IRS updates other EO online lists more frequently than once a month (or once every two months). For example, the IRS updates its online list of Form 990-N (e-Postcard) filers weekly.³⁸ The IRS should similarly update EO Select Check and EO BMF, or provide an online addendum to these databases, on a weekly basis. The IRS should be able to change the programming of the databases from monthly to weekly, just as it made the change from quarterly to monthly updating.³⁹ However, until this change can be implemented, the IRS should manually update its online databases.

Currently, in between its regular online updating schedule, the IRS can manually update its EO Select Check listings of organizations eligible to receive tax deductible contributions and automatically revoked organizations by sending a request to the TE/GE Business Systems Planning Submission Processing Programs unit and this process can be as short as a day.⁴⁰ In fact, the National Taxpayer

³⁶ IRM 21.3.8.3.8(1)(d) (Oct. 1, 2015).

³⁷ IRM 21.3.8.3.8(1)(f) (Oct. 1, 2015); IRM 21.3.8.12.13(5) (Nov. 16, 2012). An affirmation letter, Letter 4168-C, *Letter Affirming 501(c) Exemption*, is a letter sent to organizations that call the IRS wishing to obtain written confirmation of their exemption.

³⁸ See IRS, *Exempt Organizations Select Check: Frequently Asked Questions*, FAQ #5, available at http://www.irs.gov/pub/irs-tege/faqs_eo_selectcheck.pdf.

³⁹ In a response to a TAS information request regarding whether the IRS can update EO BMF and EO Select Check more frequently than the current monthly (except for January) intervals, the IRS stated that the program used to run these two extracts only runs every four weeks, and "there is no way that the IT programmers can run the extracts more frequently." TE/GE response to TAS research request (Dec. 1, 2015).

⁴⁰ TE/GE response to TAS research request (July 31, 2015). Organizations have come to TAS for assistance when they are at risk of losing grants because they are not listed in the IRS's online databases and TAS successfully advocates for a manual EO Select Check update.

Advocate has directed TAS employees to require the IRS to do these updates manually within 24 hours.⁴¹ However, the IRS states that it cannot update the EO BMF manually.⁴²

CONCLUSION

The IRS's delay in updating the online lists of EOs that are relied upon by both individuals and organizations harms reinstated organizations and misleads taxpayers, thereby abridging core taxpayer rights. This problem can be significantly mitigated if the IRS updates these lists more frequently.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Update EO BMF and Select Check on a weekly basis as is the case for Form 990-N updates.
2. Until appropriate programming changes can be made, update EO Select Check manually.
3. Implement an emergency process that, even when there is weekly updating, allows for manual database updates within 24 hours of the restoration of exempt status.

⁴¹ In a February 2015 message to TAS employees, the National Taxpayer Advocate directed her case advocates to request manual updates within 24 hours if the IRS agrees an organization should be listed on EO Select Check as eligible to receive tax deductible contributions and to request an organization's removal from the automatic revocation list if this revocation was erroneous. TAS Wednesday Weekly, *Updates to Exempt Organizations "Select Check"* (Feb. 4, 2015).

⁴² TE/GE response to TAS research request (July 31, 2015). When asked why it cannot update the EO BMF manually, the IRS stated that the EO BMF is prepared by its IT personnel during a timeframe available only once a month, "except in January IT is busy with other priorities and the EO BMF is not prepared." TE/GE response to TAS research request (Dec. 1, 2015).