EXEMPT ORGANIZATIONS

LETTER FROM THE DIRECTOR

November 2008

Dear Colleagues,

The indelible images of charitable organizations helping cities and even countries supply basic needs to their residents during disasters like Hurricane Katrina and the tsunami in Indonesia remind us of the depth and breadth of the role of tax-exempt organizations in our society. At last count, there were roughly 1.8 million tax-exempt organizations in the United States representing 3.4 trillion dollars in assets. These organizations employ 9.4 million workers, roughly 7.2 percent of the total US workforce. More exempt organizations are providing more services in more ways than ever before.

The recent upheaval in the global financial markets and the expected widespread ripple effect mean that demand for services from all types of exempt organizations will be even greater than before, while available funding likely will shrink. We in Exempt Organizations understand that the stakes of maintaining a strong, vibrant exempt sector are high, especially in these turbulent times.

Our mission is to ensure that exempt organizations understand and comply with the requirements of federal tax-exempt status. We believe that compliant organizations are better positioned to serve the public interest and meet the growing demand for their services. To facilitate that goal, our focus over the past several years has been to promote transparency, accountability, and good governance throughout the tax-exempt sector.

In keeping with these concepts, we are issuing our first Annual Report, which not only introduces our Work Plan for FY 2009, but also includes statistics and other information to provide a fuller picture of how Exempt Organizations conducts its operations. By sharing this information, we hope to demonstrate our commitment to the principles we espouse for the exempt sector.

Respectfully yours,

Lois G. Lerner

Lois G. Lerner
Director, Exempt Organizations

Inside This Report

Offices and Staffing

At the end of FY 2008, Exempt Organizations had 826 employees divided among its three offices—Examinations, Rulings and Agreements, and Customer Education and Outreach. An additional 12 employees work out of the EO Director's office, for a total EO staff of 838 employees.

EO Examinations is responsible for enforcement activities, including both compliance checks and audits of exempt organizations. EO Examinations is made up of field exam groups; the Exempt Organization Compliance Unit (EOCU), which conducts compliance checks; Review of Operations (ROO), which does follow-up reviews of organizations; and Compliance Strategies Critical Initiative (CSCI) which coordinates EO's strategic planning, monitors progress of critical initiatives, and analyzes the results of these projects. EO Examinations has 461 employees.

EO Rulings and Agreements (R&A), made up of Determinations and Quality Assurance, EO Technical, and EO Technical Guidance Quality Assurance, is responsible for reviewing applications for exemption, issuing private letter rulings, providing technical advice, and collaborating with Chief Counsel's office and the Department of the Treasury to deliver formal guidance. R&A has 355 employees.

Customer Education and Outreach (CE&O) spearheads EO's efforts to proactively help exempt organizations understand their tax responsibilities through nationwide education and outreach programs. CE&O core staff is made up of 10 full-time employees. Subject-area experts from Examinations and R&A also support EO outreach efforts and augment CE&O's mission.

Within EO's two largest functions, Examinations and R&A, 677 of the staff are technical professionals— specifically Revenue Agents and Tax Law Specialists. The majority of Tax Law Specialists are attorneys. The depth and breadth of staff experience contribute to EO's success in encouraging and monitoring compliance. The charts below provide a breakdown of IRS experience levels of managers and professional staff within EO.

Figure A: Years of Service Analysis for EO			
	Ten or More Years of Service	5-9 Years of Service	Less than 5 Years of Service
Managers	88%	8%	4%
Professional Staff	64%	15%	21%

Figure B: Years of Service Analysis for Examinations			
	Ten or More Years of Service	5-9 Years of Service	Less than 5 Years of Service
Managers	98%	--	2%
Professional Staff	68%	8%	24%

Figure C: Years of Service Analysis for Rulings and Agreements			
	Ten or More Years of Service	5-9 Years of Service	Less than 5 Years of Service
Managers	71%	22%	7%
Professional Staff	58%	26%	16%

Compliance

EO Examinations takes a multifaceted approach to compliance work, relying on non-traditional methods such as EOCU compliance checks and ROO reviews, in addition to traditional examinations.

An EOCU compliance check determines whether an organization is adhering to recordkeeping and reporting requirements and/or whether its activities are consistent with its stated tax-exempt purpose. Compliance checks can also involve questionnaires used to gather information about specific issues or segments of the tax-exempt sector.

ROO reviews look at the activities of exempt organizations using data on file and publically available information, without direct involvement with the taxpayer. These reviews can lead to compliance checks, examinations, or ROO follow-up in a later year, thus ensuring that compliance is maintained on an ongoing basis.

As the chart below illustrates, by adding compliance checks to our enforcement efforts, we were able to almost double our enforcement contacts.

In Their Own Words…

"I was most impressed by the dedication of EO Examination personnel who worked so diligently and well to accomplish our compliance goals this past year. This work was facilitated by the further refinement of the Compliance Strategies Critical Initiative (CSCI) office. CSCI worked closely with EO R&A, CE&O and Counsel to develop and propose compliance projects covering a broad range of emerging trends. CSCI also ensured delivery of our critical initiatives and analyzed the results."

Vicki Hansen
Acting Director, EO Examinations

Figure D displays the total number of returns examined through the traditional examination process. Figure E shows the total number of compliance contacts through EOCU initiatives.

Figure D:
Total number of returns examined
FY 2004 - FY 2008

| FY04	FY05	FY06	FY07	FY08
5800	4953	7079	7580	7861
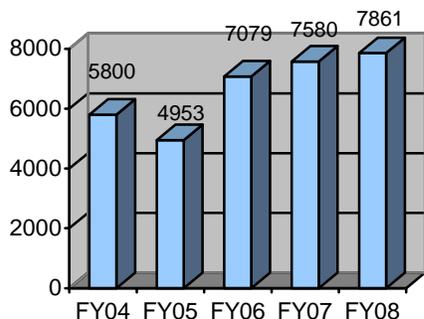
Figure E:
Total number of compliance contacts
FY 2004 - FY 2008

FY04	FY05	FY06	FY07	FY08
1475	3987	5208	6322	7466
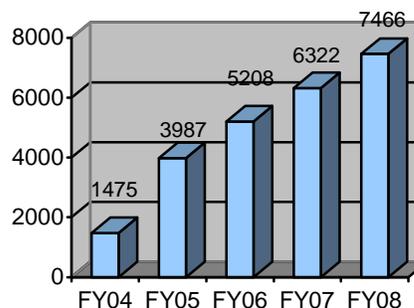
Compliance (cont.)

We have continued to use processes such as risk modeling and a comprehensive non-filer strategy to improve our case selection and help us focus our examination resources on organizations with a higher potential for noncompliance. The result is an increase in the examination change rate in FY 2008. The "change rate" represents the percentage of cases in which EO took corrective action regarding the entity. By extension, the "no change" rate refers to the percent of examinations which did not result in any EO action. As the charts below illustrate, we are doing a much better job in selecting potentially non-compliant cases for examination.

Figures F and G display the change rates of exam closures for FY 2004 and FY 2008, respectively. In FY 2004, the examination change rate was 63 percent, and in FY 2008, the change rate was 80 percent.

Figure F: FY 2004 Return Closures

37%

63%

Change
No Change

Figure G: FY 2008 Return Closures

20%

80%

Change
No Change
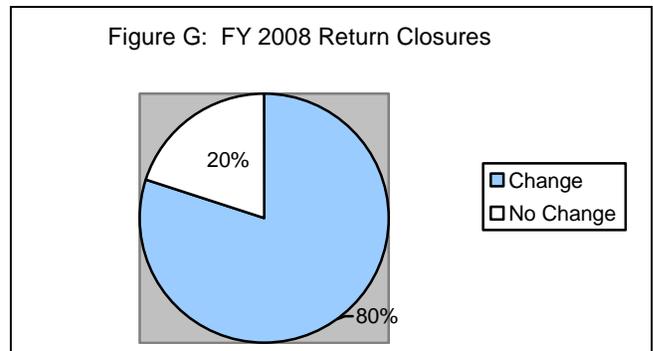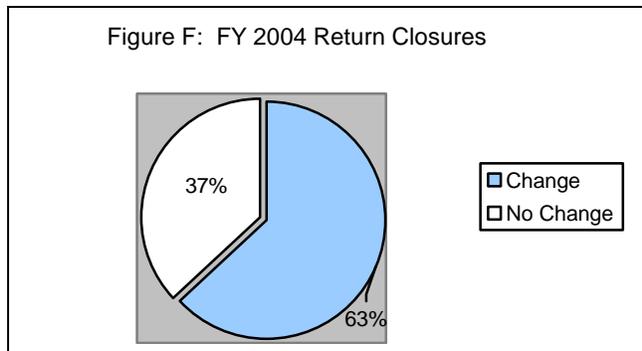
The non-filer strategy, which includes projects specifically designed to capture delinquent returns as well as incorporating a non-filer component into other exams, has resulted in a substantial increase in the numbers of delinquent returns secured over the past three years.

	Total Returns Secured
FY 2006	707
FY 2007	1581
FY 2008	1969

Applications for Tax Exemption

In Their Own Words…

"It continues to impress me that EO Determinations can efficiently process more than 70,000 applications for tax-exempt status each year. That figure, to a casual or even more experienced observer, is really staggering."

Rob Choi
Director, EO Rulings & Agreements

EO Determinations added two important components to its review of applications this year—one to decrease application processing time and the other to improve communications with our exempt organization stakeholders.

In FY 2008, EO Determinations used internet research in its review process to more efficiently evaluate applications for tax-exempt status. By using information publicly available, we were able to resolve more applications through our screening process. This enabled us to focus additional resources on complex cases that need more in-depth development.

For those cases that require in-depth development, we have added a new customer service component. We now send notices to those organizations to keep them apprised of the status of their applications. The notice establishes EO's relationships with the organization early in the process and lays a positive foundation for future communication.

Figures H and I compare the number of cases closed through the screening process and cases closed after in-depth development in FY 2004 and FY 2008, respectively. The increase in those resolved through screening is a direct result of refinements made to the screening process, which allow agents to obtain needed information with limited applicant contact.

Figure H: FY 2004 Case Closures

- 34% Screening
- 66% Full Development
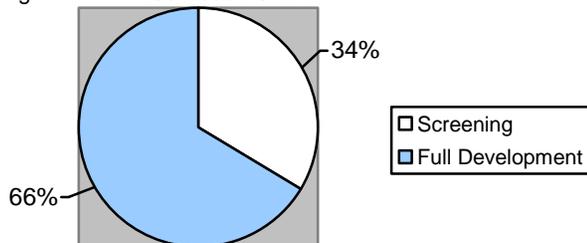
Figure I: FY 2008 Case Closures

- 41% Full Development
- 59% Screening
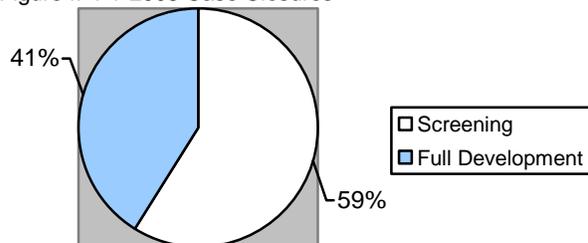
Applications for
Tax Exemption (cont.)

In FY 2008, Determinations expanded its use of Guide Sheets, to provide guidance and promote consistency in dealing with difficult issues. Guide Sheets are posted on the "Charities and Nonprofits" section of IRS.gov. Public disclosure of the specific criteria used during the Determination process increases transparency and helps organizations comply with tax laws.

In addition to determining that an organization qualifies for tax exemption, EO strives to ensure that an organization's practices remain consistent with its stated mission and purpose. Many applicants for tax-exempt status are brand new organizations and have not yet begun operations. Starting in FY 2008, EO Determination Specialists began referring selected organizations identified in the Determination process to the ROO for future follow-up. This promoted more expeditious approval of tax-exemption while ensuring organizations remain compliant.

Guide Sheets on the following topics were written and released in FY 2008:

- *IRC 509(a)(3) Supporting Organizations, Type I and II* **(released March 2008)**

- *IRC 509(a)(3) Supporting Organizations, Type III* **(released March 2008)**

- *Donor Advised Funds* **(released July 2008)**

Education and Formal Guidance

EO is committed to educating the tax-exempt sector and sharing information about our programs with the public. To this end, we have expanded and diversified efforts to communicate, update, and share our activities by balancing "in-person" presentations with "round the clock" availability.

- The "Charities and Non-Profits" section of IRS.gov has approximately 1600 articles on 70 pages devoted specifically to tax-exempt organizations. Public reliance on the internet to provide timely and relevant information has grown exponentially, and we certainly met the demand in FY 2008.

- Using the *EO Update,* our free subscription newsletter, we share new information with stakeholders who have registered to receive these updates. By the end of FY 2008, we had over 75,000 subscribers, an increase of 129 percent over the last year. These updates are also available on our Web site.

- We introduced five mini-courses to our popular on-line Web site StayExempt.org. This Web-based form of outreach ensures that EO resources and guidance are available to every potential customer with access to the internet.

The public's growing reliance on the "Charities and Non-Profits" pages is illustrated by an 81 percent increase since FY 2005, in the number of views of our landing page, as shown in Figure J.

Figure J: EO Landing Page Views
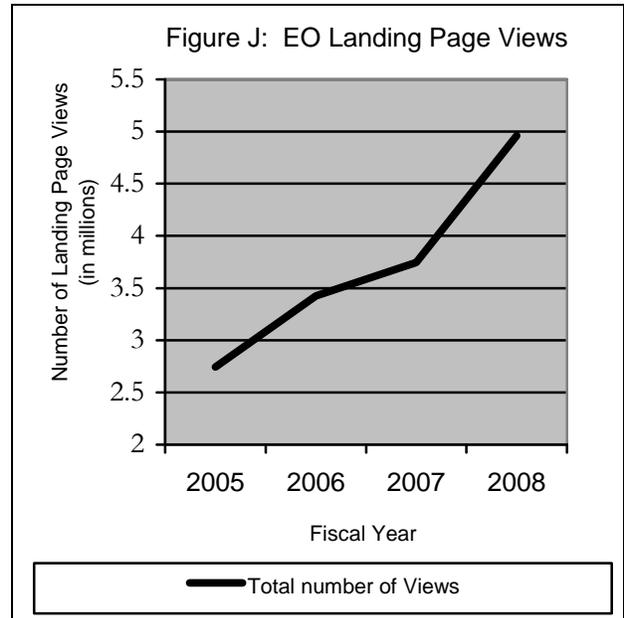
Each of the five mini-courses includes an audio presentation, supported by a PowerPoint presentation and full text of the script. Topics are:

- *Navigating IRS Resources for Tax-Exempt Organizations*

- *Political Campaigns and Charities: The Ban on Political Campaign Intervention*

- *The Wonderful World of Foundation Classification (Part I)*

- *Can I Deduct My Charitable Contributions?*

- *Applying for Tax-Exempt Status*

Education and Formal Guidance (cont.)

Demand for in-person presentations continued to grow in FY 2008. Due in large part to the release of the redesigned Form 990 and the new Form 990-N (e-Postcard), requests for speakers increased nearly 50 percent over the previous year. To reach a broader audience, we offered 19 two-hour workshops on the new Form 990 at the six 2008 nationwide Tax Forums and introduced the form changes during our 17 Small and Mid-size Workshops in six cities across the country. In all, 41,752 people attended the speeches, Tax Forums, and Workshops.

On the international front, EO saw an increase in requests to meet with foreign delegations to discuss our regulation and oversight of the tax-exempt sector. In FY 2008, we shared our best practices with our professional counterparts from other countries, including Japan, Russia, New Zealand, Ireland, Mexico, and Canada.

In Their Own Words…

"Without a doubt, our extensive grassroots campaign to educate small organizations of their new requirement to file an e-Postcard was the CE&O accomplishment of the year for FY 2008. Faced with the challenge of identifying and helping the small "mom and pop" organizations, we extended our outreach campaign well beyond the norm. We reached out to friends, family, coworkers – anyone who knew someone involved with a small charity. The number of small charities that have already filed the e-Postcard is proof that our outreach strategy was a resounding success."

Bobby Zarin, Director
EO Customer Education & Outreach

Figure K shows FY 2008 outreach efforts and the percentage of increase over FY 2007.

Figure K: EO Education and Outreach Efforts

Outreach Efforts	FY 2008 Total	Increase over FY 2007
EO Update subscribers	75,499	129%
Speeches, Tax Forum and Workshops	289	48%
IRS.gov/eo page views	4,634,339	24%

Education and Formal Guidance (cont.)

The regulations corresponding to the redesigned Form 990 led to another significant achievement in FY 2008, the elimination of the advance ruling process. Under the advance ruling process applicant organizations automatically were granted public charity status for their first five years; after which they had to come back in and demonstrate they in fact had sufficient public support during that initial period. Over the years, approximately 95 percent of the exempt organizations granted advance rulings retained their public charity status. Given the high recognition rate, coupled with the public support information now required on the new Form 990, it made sense to eliminate the second step of the process. This change will make our exemption process more efficient and reduce the burden on exempt organizations.

EO makes technical interpretations of the laws and procedures publically available through regulations, revenue rulings, revenue procedures, announcements, and notices.

In FY 2008, published guidance included:

- Regulations implementing the e-Postcard filing requirement for small tax-exempt organizations

- Regulations on the interplay of section 501(c)(3) exemption standards and the imposition of section 4958 intermediate sanctions excise tax

- Regulations implementing the revised Form 990 and eliminating the advance ruling process for publicly supported organizations

- Advance Notice of Proposed Rulemaking on supporting organization payout and definition of functionally integrated supporting organization

- Notice 2008-49 (implementing technical correction to the Pension Protection Act (PPA) regarding public disclosure of Form 990-T)

- Notice 2008-6 (transitional relief and filing instructions for certain charitable trusts whose public charity status changed as a result of PPA)

Spotlight On the Redesigned Form 990

The redesign of the Form 990 and its instructions, finalized in FY 2008, is the most significant EO accomplishment in the past 30 years. The new form reflects the diversity and complexity of today's tax-exempt sector; it also reflects changes in the law and regulatory landscape.

Stakeholder involvement was critical to the redesign effort. EO posted the draft redesigned form on IRS.gov to solicit feedback from the public and to educate the nonprofit community prior to the form's official release. During the comment period, we received over 3,000 pages of comments and feedback from over 800 stakeholders. We studied the public's comments and made changes. After thorough review and numerous discussions with the sector, we incorporated many of the suggestions into the final form and instructions months before the official release of the form. To provide maximum advance notice to the sector, we released the final form and instructions along with extensive background and explanatory information on IRS.gov.

The new Form 990 consists of a core form to be completed by each Form 990 filer and a series of schedules designed to require reporting of information only from those organizations that conduct particular activities.

The redesigned Form 990 embodies EO's goals of:

- *Increasing transparency* by giving the IRS and the public a more comprehensive picture of a tax-exempt organization, including its mission, programs and goals, its revenues and expenses, and its internal policies and practices;

- *Promoting accountability* by publically sharing the way that organizations use their assets and conduct their operations; and

- *Encouraging compliance* by accurately reporting on the organization's operations so the IRS may effectively assess the risk of noncompliance.

The following timeline provides a picture of the overall Form 990 redesign process.

Form 990 Redesign Project: FY 2008 Milestones

Pre-FY 2008

- **June 07:** Discussion draft of redesigned Form 990 released for public comment
- **July 07:** Phone forums held on draft redesigned Form 990
- **Sept 07:** Public comment period on redesigned Form 990 closes; approximately 700 comments received

Oct 07
**

Nov 07
**

- **Dec 07:** Redesigned 2008 Form 990 released; filing thresholds adjusted to provide transition

Dec 07
**

Jan 08
**

Feb 08
**

Mar 08
**

- **April 08:** Draft instructions released for public comment

Apr 08
**

May 08
**

Jun 08
**

- **June 08:** Opportunity for public comment on draft instructions closes; approximately 125 comments received

- **July 08:** Workshops on redesigned Form 990 offered at 2008 Tax Forums continued through September

July 08
**

Aug 08
**

- **Aug 08:** 2008 Form 990 instructions released

- **Sept 08:** Form 990 regulations released; 2008 Form 990-EZ instructions released

Sept 08
**

Post-FY 2008

- **Nov 08:** Mini-courses in *Preparing to File the New Form 990* and *The Redesigned Form 990* released to public; IRS Tax Talk Today: *Preparing the New Form 990*
- **Dec 08:** Final 2008 Form 990, Form 990-EZ, and instructions posted online

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Spotlight On the 2008 e-Postcard

In January 2008, EO successfully launched a new electronic filing system for small organizations that previously did not have a filing requirement. The Pension Protection Act of 2006 mandated that organizations with gross receipts of $25,000 or less must annually provide the IRS with basic information, such as a current mailing address, the name and address of a principal officer, and a confirmation that gross receipts are $25,000 or less. This new legislation created a twofold challenge:

- Design, test and launch a new electronic filing system and disclosure Web site, and

- Communicate the new filing requirement to a segment of the tax-exempt community that historically had little or no contact with the IRS after approval of their application for tax-exempt status.

Initially, we identified 640,000 potential e-Postcard filers in our database and mailed each organization a letter explaining the new filing requirement. To test the effectiveness of our communication efforts and to determine whether these small organizations would be ready to electronically file the e-Postcard, we conducted a survey of the filing population. The survey questions focused on how many organizations were still in existence, how many knew about the new filing requirement, and how many planned to file the e-Postcard. While responses to the survey indicated that our communications were clear, they also suggested that many of these organizations may no longer be operating or may not qualify to file the e-Postcard. Based on survey results and historical filing patterns, we arrived at an expected filing population of approximately 166,000 filers.

To try to alert as many potential filers as possible, we used non-traditional sources including contacting libraries and congressional offices – asking everyone to help get the word out. In January 2008, when we launched the new filing system, small organizations immediately began filing their e-Postcards. By May 15, 2008, the first filing deadline, over 106,000 small organizations successfully filed their e-Postcard. By the end of September, the total was nearly 167,000.

Spotlight On the Federal and State Project

In addition to oversight by the IRS, tax-exempt organizations are subject to oversight by state charity regulators, including state attorneys general and state tax authorities. The Internal Revenue Code allows the IRS to disclose certain information about exempt organizations to its state counterparts. State charity regulators also provide information to the IRS about potential tax law violations. This two-way exchange of information allows both EO and state enforcement authorities to leverage collective resources to ensure compliance with laws governing exempt organizations.

6104(c) Disclosures

The Pension Protection Act of 2006 allows EO to make disclosures to the states earlier in our investigative processes than under prior law, and expands the scope of the information that EO can share. At the same time, it tightened the security and safeguard requirements a state must meet to be eligible for the exchange. EO has been working closely with the states to help them meet these tighter requirements. In FY 2008, EO disclosed information concerning the following enforcement activities to state agencies:

Enforcement Activities	Disclosures to State Agencies
Revocations	16
Excise Taxes	14
Terminations	161
Denials	5
TOTAL	196

State Referral Program

In FY 2008, state charity officials made 83 referrals to EO on issues such as:

- Qualification for exemption,
- Private benefit and inurement,
- Nonfilers,
- Political activities,
- Employment tax, and
- Failure to operate in accordance with designated exemption status.

EO Milestones FY99 - Present

	Legislation
7/1/2000	Public Law 106-230: notice and reporting requirements for tax-exempt political organizations
11/2/2002	Public Law 107-276: eliminated notice and return requirements for certain state and local organizations, and mandated electronic filing for some reports.
10/22/2004	American Jobs Creation Act of 2004, P.L. 108-357: Required donee of donated vehicles to give donor written acknowledgement; allowed donor of intellectual property an enhanced deduction for charitable contribution based on income from the property.
5/17/2006	Tax Increase Prevention and Reconciliation Act of 2005, P.L. 109-222: Increased tax shelter penalties on tax-exempt accommodation parties that are involved in certain prohibited tax shelter transactions and adopted new disclosure requirements.
8/17/2006	Pension Protection Act of 2006: Required small exempt organizations to file an annual electronic notice and public disclosure of unrelated business income tax returns, increased excise taxes, and adopted new requirements for some potentially abusive situations.

	Hearings
4/1/2003	Tax Scams and Schemes (Senate Finance Committee)
11/20/2003	Abusive Tax Shelters (Senate Permanent Subcommittee on Investigations)
11/20/2003	Credit Counseling (House Ways & Means Subcommittee)
6/22/2004	Charitable Giving Problems and Best Practices (Senate Finance Committee)
7/21/2004	Tax Gap/Deferring Abuses – TE/GE Reform Proposals (Senate Finance Committee)
7/22/2004	Reform Roundtables (Senate Finance Committee)
4/5/2005	Exempt Organizations Overview (Senate Finance Committee)
5/26/2005	Tax-Exempt Hospitals (House Ways & Means Subcommittee)
6/8/2005	Conservation Easements (Senate Finance Committee)
6/23/2005	Façade Easements (House Ways & Means Subcommittee)
9/8/2005	College Endowment Roundtable (Senate Finance Committee)
11/3/2005	Credit Unions (House Ways & Means Subcommittee)
3/3/2006	Governance Roundtables (Senate Finance Committee)
5/25/2006	Enforcement of Charities' Payroll Taxes (House Ways & Means Subcommittee)
9/6/2006	Executive Compensation (Senate Finance Committee)
9/13/2006	Tax-Exempt Hospitals (Senate Finance Committee)

9/25/2007	Whether Charitable Organizations Serve the Needs of Diverse Communities (House Ways & Means Oversight Subcommittee)
10/30/2007	Nonprofit Hospital Roundtable (Senate Finance Committee)

Compliance Projects

2/2006	Political Activity Compliance Initiative (2004 Election)
5/2006	Credit Counseling
3/2007	Down Payment Assistance
3/2007	Executive Compensation
7/2007	Hospitals
7/2007	Community Foundations
9/2008	Tax-Exempt Charitable Financing
10/2008	Colleges and Universities

Disaster Relief

10/2001	September 11 Terrorist Attacks
12/2004	Tsunami Relief
2005	Hurricanes Katrina, Rita, and Wilma

Filing

7/8/2003	Launch of Political Organization Filing and Disclosure Web Site
3/30/2004	Electronic Filing - available for exempt organizations
1/11/2005	Electronic Filing - required for certain large exempt organizations
2/25/2008	e-Postcard filing and disclosure sites available

Forms

11/1/2004	Revised Form 1023
2/25/2008	Form 990-N (e-Postcard)
8/19/2008	Revised Form 990 and instructions
8/5/2008	990-EZ filing requirements adjusted temporarily as part of transition to redesigned Form 990

Publications

9/2001	Publication 3833, *Disaster Relief, Providing Assistance through Charitable Organizations*
3/2002	Publication 1771, *Charitable Contributions, Substantiation and Disclosure Requirements*
7/2002	Publication 1828, *Tax Guide for Churches and Religious Organizations*
9/2003	Publication 4220, *Applying for 501(c)(3) Tax-Exempt Status*
9/2003	Compliance guides

- Publication 4221-PC, *Compliance Guide for 501(c)(3) Public Charities*
- Publication 4221-PF, *Compliance Guide for 501(c)(3) Private Foundations*

6/2004   Vehicle donation publications
- Publication 4302, *A Charity's Guide to Vehicle Donations*
- Publication 4303, *A Donor's Guide to Vehicle Donations*

8/2007   Publication 4630, *Exempt Organizations Products and Services Navigator*

	On-line Resources
6/2005	Life Cycle of a Public Charity
10/2005	Life Cycle of a Private Foundation
1/2007	StayExempt.org (virtual workshop)
6/2007	Life Cycle of an Exempt Organization

- Life Cycle of a Social Welfare Organization
- Life Cycle of an Agricultural or Horticultural Organization
- Life Cycle of a Labor Organization
- Life Cycle of a Business League (Trade Association)

2/2008	Governance for Charities
9/2008	Web-based mini-courses
various	Tax Talk Today
various	Phone Forums

FY 2009 Work Plan

The past two years have introduced two momentous changes to the tax-exempt community: the Pension Protection Act of 2006 (PPA) and the redesign of the Form 990 information return, the most significant revision in almost 30 years. These changes were triggered by the increasing size, diversity, and complexity of the exempt sector, along with the need to proactively address potential misuse of tax-exempt organizations and/or tax-exempt status.

The FY 2009 Work Plan addresses the impact of these changes on the coming year, introduces new initiatives, and discusses projects about to come to fruition.

Improved Service to Achieve Voluntary Compliance

Preparing and Helping To File the Form 990
Now that the redesigned Form 990 is a reality, we will work with the members of the sector to prepare them for their new filing requirements. The new Form requires more information about operations; internal policies and practices, including foreign activities, executive compensation, governance, and fundraising; and provides tax-exempt organizations a better opportunity to describe for the public their mission, programs, and goals. Organizations may need input from program staff and board members in ways they have not before, and they may need to re-assess and update their internal systems to reflect the new reporting requirements.

Form 990 Filing Thresholds		
Tax Year*	**Gross Receipts**	**Assets**
2008	*>$1M or*	*>$2.5M*
2009	*>$500K or*	*>$1.25M*
2010 and later	*>$200K or*	*>$500K*
*To be filed in the following year		

To assist with this transition, in FY 2009 we will continue to provide speakers for speeches, workshops, and tax forums. We also will offer the following Web-based tools:

- on-line mini-courses (similar to "podcasts") on StayExempt.org,
- a Tax Talk Today program on the Form 990 (November 2008), and
- webinars on specific aspects of the Form.

As we receive the new 990s, we will begin to evaluate the information reported; interact with the regulated community to obtain feedback of any challenges encountered; and assess whether the form is serving its intended purpose. As the filing thresholds change during the three-year transition period, we will reach out to a broader universe of new filers.

Form 990-N (e-Postcard)
Beginning in 2008, small tax-exempt organizations are required to file an annual electronic information notice, Form 990-N, with the IRS. Failure to file for three consecutive years results in automatic loss of tax-exempt status, so we have developed an extensive, multi-year outreach plan to alert the community about this new requirement. While we are pleased with the results thus far—we have received almost 200,000 e-Postcards filed during the first nine months of the first year—we will continue our outreach efforts in FY 2009 to ensure that all organizations are aware of their filing responsibilities.

DON'T THROW AWAY YOUR **TAX-EXEMPT** STATUS

Small tax-exempt organizations have a new filing requirement. For details go to
www.irs.gov/eo

Guidance
In FY 2009, we will work with Chief Counsel and Treasury to issue new guidance. Some of the topics are listed below.

- Guidance on a voluntary compliance program for exempt organizations
- Revenue procedure to modify the publication requirement by a private school of its nondiscriminatory policy, contained in Revenue Procedure 75-50
- Proposed regulations on new requirements for supporting organizations as added by the PPA
- Final regulations on excise taxes on prohibited tax shelter transactions and related disclosure requirements
- Proposed regulations on excise taxes on donor advised funds, as added by the PPA
- Regulations to implement Form 990 revisions (published on Sept. 9, 2008)
- Proposed regulations to update regulations under Code section 6104(c), relating to disclosure to state charity agencies for changes made by the PPA

Exempt Organizations Voluntary Compliance Program (EOVCP)
In its 2007 report, the Advisory Committee on Tax Exempt and Governmental Entities (ACT) identified the PPA threat of automatic revocation for failure to file the 990 as a powerful incentive to encourage non-filing tax-exempt organizations to rectify their reporting failures. The ACT recommended that the IRS implement a voluntary compliance program to help bring non-filers into compliance before the automatic revocation process begins, and in FY 2009, we expect to implement an EOVCP to address the concern.

Looking Through the Eyes of the Exempt Community: Improving IRS.gov/eo
While we have been successful in providing information that addresses the diverse needs of the sector, we have become victims of our own success. Displaying information on the Web in a logical and easy-to-use manner within the structure of IRS.gov has become a challenge for us. So, in FY 2009, we will seek input from the public, using focus groups, usability studies, and surveys, to garner ideas for making improvements to the Web site.

Helping To Prepare Future Non-Profit Leaders
As the tax-exempt sector continues to grow, it is important to prepare the non-profit leaders of the future. A good understanding of non-profit tax law is crucial when establishing and managing a non-profit organization. Familiarizing non-profit leaders with the tax law promotes good governance and ensures that non-profit organizations can continue to accomplish their missions. To that end, EO will develop a new educational tool for academic institutions, research centers and other entities that work to develop, cultivate and promote professionals who shape the non-profit sector.

Enforcement of the Tax Law and Tax Compliance Initiatives

EO's strategic approach to enforcement of the tax law is accomplished through a framework we call the "Vision for Compliance." The "Vision" starts with strategic planning to detect emerging or possible areas of non-compliance; then uses appropriate methods or tools—compliance checks or questionnaires, examinations, focused application screening—to study and/or resolve; provides guidance to educate; increases transparency by issuing public reports outlining the project and results; and continues by monitoring previous non-compliant and new organizations.
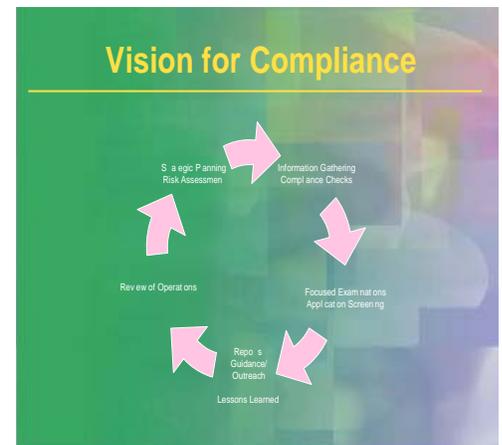
The remainder of this report discusses some new compliance projects initiated through strategic planning that will begin in FY 2009, and highlights some on-going compliance initiatives that are in later stages of the "Vision." We plan to release public reports on the second group in FY 2009.

New FY 2009 Compliance Initiatives

Charitable Spending Initiative
EO will begin a long-range study to learn more about sources and uses of funds in the charitable sector and their impact on the accomplishment of charitable purposes. We will look at fundraising, public contributions, grants, and revenues from related or unrelated trades or businesses, types and amounts of direct and indirect unrelated business income expenses, officer compensation, fundraising expenses, program service activities and the effect each has on funds available for charitable spending. The first stage of this initiative will focus on organizations with unusual fundraising levels and organizations that report unrelated trade or business activity and relatively low levels of program service expenditures.

Gifts In-Kind
In FY 2009, we will look at valuation issues surrounding non-cash gifts, such as pharmaceuticals, used clothing, or excess inventory of discontinued products, provided to 501(c)(3) organizations, that then turn around and contribute them to other domestic or international charities. We will focus on how the non-cash gifts are valued, the expenditures involved in the transactions, and the accuracy of the reporting on the Form 990.

Governance
EO will continue its work in the nonprofit governance area by focusing on three areas. First, it will develop a checklist to be used by agents in examinations of exempt organizations to determine whether the organization's governance practices impacted the tax compliance issues identified in the examination and to educate organizations about possible governance considerations. Second, EO will commence a training program to educate its employees about nonprofit governance implications in the determinations, rulings and agreements, and education and outreach areas. Third, EO will begin identifying Form 990 governance questions that could be used in conjunction with other Form 990 information in possible compliance initiatives, such as those involving executive compensation, transactions with interested persons, solicitations of noncash contributions, or diversion or misuse of exempt assets.

Mutual Organizations
Mutual organizations are exempt under section 501(c)(12) and include benevolent life insurance associations, ditch or irrigation companies, telephone companies, electric companies, and other similar organizations. In order to qualify for tax exemption, a mutual organization must be organized and operated on a cooperative or mutual basis, receive at least 85 percent of its income from its members, and use its member income for specific services. If, in any year, its member income falls below 85 percent of its total income for the year, the organization does not automatically lose its tax exemption, but is required to file a Form 1120, *U.S. Corporation Income Tax Return*, for that year.

In FY 2009, we will send compliance check letters to a number of organizations whose Forms 990 indicate they may have failed the member income test and we will take appropriate action, such as obtaining the delinquent tax Forms 1120 or conducting field examinations.

Student Loan Organizations

The current financial crisis is making it harder for students to get traditional bank loans. More students will be turning to student loan organizations to help fund their college expenses. Some tax-exempt student loan organizations have set up related for-profit subsidiaries, partially or completely owned by the officers of the exempt organization. The Review of Operations (ROO) will look at internal and external information to identify student loan organizations with related for-profits that may be providing impermissible benefits to insiders or third parties. Appropriate cases will be referred for examination.

We will use various sources of information, including Forms 990, internal or external databases, compliance studies and questionnaires, and examinations. The initiative also will include an executive compensation component, which may review compensation amounts in relation to program service revenues, gross receipts and/or program service expenditures.

### On-going Compliance Initiatives

Colleges and Universities

In FY 2008, working with the sector, we developed a compliance check questionnaire for colleges and universities, one of the largest segments of the exempt organization universe. In October, we sent 400 questionnaires to a cross-section of small, mid-sized and large private and public four-year colleges and universities. The questionnaire focuses on relationships between related and unrelated entities, unrelated business income, endowments, and executive compensation practices.

A major objective of the questionnaire is gathering information about how these schools report revenues and expenses from their trade or business activities, classify their activities as exempt or taxable activities, and calculate and report income or losses on taxable activities. The questionnaire also seeks information about how the organizations invest and use their endowment funds and determine compensation of certain highly paid individuals. Once we receive and analyze the responses, we will issue a public report of the results. We also will conduct examinations focused on unrelated business income and executive compensation on a sample of the organizations.

Political Activities Compliance Initiative (PACI)
The PACI program promotes compliance with the IRC 501(c)(3) prohibition against political intervention by tax-exempt organizations. Now that the 2008 election is over, EO will prepare a PACI report which will:

- summarize the types of 2008 allegations of political intervention;
- report the results of the on-going PACI efforts;
- make recommendations for the future direction of the PACI program;
- assess the effectiveness of the statutory tools available to address instances of political intervention; and
- identify any troubling trends.
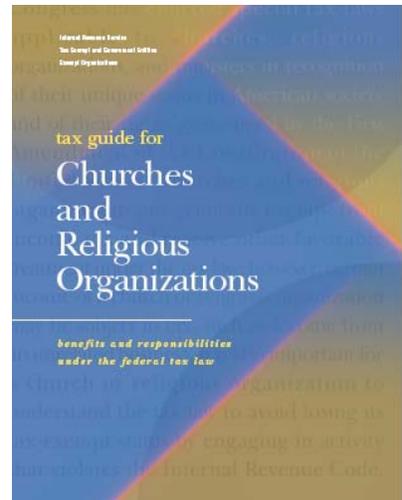
EO also will consider a project to review the flow of funds and other resources between affiliated groups of organizations that include one or more section 501(c)(3) organizations, one or more section 501(c)(4) organizations, and one or more section 527 organizations. The project will help us understand how these affiliations work and to ensure that campaign activity is not being subsidized by the section 501(c)(3) organization and/or flowing to alternative sources to avoid disclosure.

Hospitals
In FY 2007, EO released an interim report on our nonprofit hospital project. The report discussed the initial results of the compliance check questionnaire as it related to the community benefit issue. The report recommended we further evaluate the results by obtaining additional research and analyze the differences in community benefit expenditure amounts and types to take into account varying demographics, such as rural and urban communities and hospitals.

In FY 2009, we will issue a follow-up report discussing the results of our analysis on the community benefit issue, as well as the results of the executive compensation examinations conducted in this project.

Community Foundations
Community foundations began as a small group of charitable trusts established at local banks or trust companies to benefit residents through scholarship or other similar grantmaking programs. Over the past decade, there has been a significant increase in the number, size and complexity of community foundations and their grantmaking and other operations, including donor advised funds.

EO sent compliance questionnaires to over 3,000 organizations to gather information on how community foundations operate, to learn about their relationships with other entities, and to determine whether they are complying with section 501(c)(3). Based on responses, it appears that a significant number may be something other than community foundations. In 2009, we will design a follow-up project to properly classify those organizations. We also will begin examinations of community foundation organizations identified through the compliance checks.

Non-Filer Initiatives – Ongoing
Ensuring exempt organizations file the required forms establishes the foundation for compliance. Although most compliance initiatives include a non-filer component, in FY 2009 we will focus on three on-going initiatives specifically developed to secure delinquent returns from exempt organizations.

- *Gaming*
  Organizations involved in gaming sometimes fail to file returns and/or fail to report gaming activity or withhold income tax, pay employment taxes, or report unrelated business income with the IRS. Many of these organizations are required to report this information with their state tax agencies.

  In FY 2007 and 2008, we secured and researched 18 state databases to identify organizations that had filed with the state but not with the IRS. Based on this information, we opened examinations on approximately 800 organizations that failed to file Forms 990. The examinations uncovered numerous other delinquent filings, including Forms 990-T, 940, 941, 945, 730 and 11C.

  In FY 2009, we will complete the examinations and report the results of our findings.

- *Employment Taxes/CAWR*
  The Combined Annual Wage Reporting (CAWR) computer program compares Form W-2 data reported to the Social Security Administration (SSA) with employer (payer) Form 941 data reported to IRS. Through the use of this matching program, the CAWR Project seeks to obtain delinquent employment tax forms; resolve inconsistencies in forms on file; and correct inaccurate credit balances on employment tax modules. This project secures delinquent 941s, 940s, W-2/W-3s, etc. and ensures that the amounts match.

  In FY 2008, EO completed the initial phase of the CAWR compliance checks and field examinations. In FY 2009, we will report on the project and continue to identify non-filers through the CAWR program.

- *Form 990 Non-Filers*
  The project will identify potential non-filers from three categories:
    - Form 990 and 990-PF intermittent filers with reported high dollar gross receipts;
    - Form 990-T filers showing substantial unrelated business income gross receipts without a corresponding Form 990 filing; and
    - Form 1098-C (Contributions of Motor Vehicles, Boats, and Airplanes) filers reporting high dollar donations to their organizations without a corresponding Form 990.

Determinations

Public Charity Status
In September 2008, the IRS and the Treasury Department issued [new regulations](#) that streamlined the approval process for organizations seeking tax-exempt status as publicly supported charities. The new regulations eliminated the so-called "advance rulings" that granted public charity status for an initial five-year period but required exempt organizations to demonstrate, after that period, that they received enough public support to retain their public charity status.

We were able to eliminate the advance ruling process because of the recent redesign of the Form 990, the tax return filed by organizations exempt from federal income tax. By relying on the revised Schedule A of the new Form 990 and other traditional techniques, we can ensure organizations are complying with the rules for publicly supported charity status on an ongoing basis.

In FY 2009, we will develop post-advance ruling procedures to monitor the public charity status of 501(c)(3) organizations.

Cyber Assistant: Web-Based Application for Tax-Exemption
To help new organizations meet the requirements for obtaining and maintaining tax-exempt status and to assist them in completing their exemption application, we have developed "Cyber Assistant."

Cyber Assistant is a Web-based tool that will guide an applicant through the application process while providing education about the duties and responsibilities that go along with tax-exempt status. The program solicits information about the applicant and builds an exemption application based on the user's responses. The program also alerts the user to errors in the application and prompts her to supply missing information. The final product is a complete exemption application that is printed and mailed to the IRS. Bar codes on the printed form capture data from the application, enabling more expeditious processing. In 2009, we are testing the process with interested developers.

Investing in Tomorrow

Like the rest of the government, the private sector and the IRS, Exempt Organizations is facing the potential retirement of a number of experienced and talented "baby boom" era employees in the coming years. Although we will miss our fellow employees and regret the loss of their considerable experience, we are preparing for the future and have adopted a three-pronged approach to cultivate leadership, transfer skills, and increase technical knowledge.

- Recruit and hire talented new employees from programs such as the Presidential Management Program (PMF), a federal leadership program, to staff our workforce of tomorrow;

- Launch skills-transfer and mentoring programs to prevent the loss of institutional knowledge and ensure the staff has the skills to do their job, and encourage them to take advantage of the professional development offered by the IRS, such as continuing education programs; and

- Identify tomorrow's leaders, early in their career, through a comprehensive leadership succession program. This formal, structured process allows EO managers to assess employees' leadership potential early and provide developmental opportunities for those individuals. It helps identify where development is needed so those aspiring to lead can build the right skills and be ready when an opportunity presents itself.

By following this course, we are ensuring that we have both capable management and requisite technical expertise necessary to move toward the future.