

## Articles

February 5, 2013

### AUTHORS

Matthew T. Journy  
Margaret C. Rohlwing  
George E. Constantine  
Jeffrey S. Tenenbaum

### RELATED PRACTICES

Tax-Exempt Organizations

### RELATED INDUSTRIES

Nonprofit Organizations  
and Associations

### ARCHIVES

2013    2009    2005  
2012    2008    2004  
2011    2007    2003  
2010    2006

## IRS Releases Exempt Organizations 2012 Annual Report and 2013 Workplan

*Nonprofit Alert*

Related Topic Area(s): Tax and Employee Benefits

The Internal Revenue Service (IRS) recently issued its **Exempt Organizations 2012 Annual Report and 2013 Workplan** (Workplan). The Workplan provides information and guidance for tax-exempt organizations regarding compliance issues that the IRS has identified from prior years and the steps it will take in the upcoming year to address those issues.

### **2012 Activities**

The IRS examined 10,743 returns in 2012, down from 11,699 in 2011 but almost double the number of returns examined 10 years earlier. Based on information reported over the last three years, the IRS will likely examine between 10,000 and 12,000 returns in 2013.

In addition to its regular examinations, the IRS conducted 3,277 compliance checks in 2012. The IRS uses compliance checks to more efficiently obtain information from the taxpayer about the activities of both individual taxpayers and entire industries. Though they are less formal and intrusive, it is important to understand that compliance checks may, and often do, result in full IRS examinations.

### **Governance**

The IRS continued its governance study in 2012 and completed its analysis of **Governance Check Sheets** from § 501(c)(3) organizations. Based on this analysis, the IRS released a list of best practices for governance of public charities, which includes having a written mission statement, using comparability data when making compensation decisions, having controls in place to ensure proper use of charitable assets, and requiring the full board to review the Form 990 before filing. The IRS will continue this study and select a sample of § 501(c)(3) and § 501(c)(4) organizations in 2013 using a similar checklist and focusing in particular on practices that lead to compliance and those related to noncompliance.

Also in 2012, the IRS reviewed the filings of 285 organizations that reported a significant diversion of assets on their Forms 990 in 2009 to investigate how governance practices might contribute to these diversions. In 2013, the IRS plans to conduct examinations and reviews of governance practices for these organizations reporting a significant diversion of assets. The examinations will focus on practices before and after the diversion.

### **Automatic Revocation and Reinstatement**

The IRS reports that over 450,000 organizations have lost their tax-exempt status since the passage of the Pension Protection Act of 2006 which provides for automatic revocation in some instances. Of these, about 30,000 organizations have applied for reinstatement. Many of these organizations are small and, in 2012, the IRS took several measures to assist with reinstatements by offering **transitional relief** such as reduced filing fees. The IRS also is working to keep the list of organizations with automatically revoked statuses up to date; in March 2013, it will begin adding organizations to the list within a month of the revocation date.

### **The Affordable Health Care Act**

Last year, the IRS continued to focus on implementing portions of the Affordable Health Care Act (AHCA) that affect exempt organizations such as charitable hospitals. In 2012, the IRS made revisions to the Form 990 and Form 990 Schedule H to allow such organizations to report compliance with AHCA requirements. In addition, the IRS has issued proposed new regulations on requirements for charitable hospitals as well as a **notice** soliciting comments on community health needs assessment

requirements.

### **Coordination with States**

The IRS can share information about exempt organizations with state regulators who meet specific requirements and can also accept referrals from state regulators. In 2011, the IRS received over 100 referrals from state regulators in 19 states. Many of the issues in these referrals concerned private benefit and inurement, nonfilers, political activities by § 501(c)(3) organizations, employment tax issues, and organizations not operating in accordance with their tax-exempt status. As of the end of 2012, eight states had qualified for IRS information sharing.

### **2013 Workplan**

The Workplan explains where the IRS will be focusing its exempt organization efforts in 2013, and it indicates that the IRS will continue to use compliance checks and Forms 990 to target exempt organizations for examinations throughout the year.

### **Form 990 Compliance Efforts**

The IRS has recently been using filed Forms 990 to investigate a variety of tax issues and it has developed internal indicators to help it identify and select organizations for examination based on Form 990 responses.

#### *Compensation*

Examinations of a random sample of 200 organizations related to compensation transparency will begin in 2013. In selecting these organizations, the IRS focused on those that reported amounts of compensation for all officers, directors, trustees, and other key employees that are inconsistent with the amount reported by other organizations with similar amounts of gross receipts.

#### *Political Activities*

In 2012, the IRS developed internal indicators for noncompliance with political activity restrictions to use in evaluating filed Forms 990. The IRS has already begun to use those indicators to create a two-track system to evaluate these issues. About 300 cases involving unlawful political campaign intervention by tax-exempt organizations have already been identified, and the IRS plans to send these cases to a committee to determine the necessity of an examination. In addition, the IRS also receives referrals from outside sources alerting it to prohibited political activity and these referrals will be evaluated through a committee system going forward.

#### *Unrelated Business Income*

This year, the IRS plans to examine a sample of organizations that specifically reported substantial gross unrelated business income in the last three tax years and did not report any income tax due during those years. Last year, the IRS completed compliance checks of over 400 organizations reporting unrelated business income that did not file a Form 990-T, leading to over \$260,000 in tax payments.

#### *Charitable Spending Initiative*

The IRS uses data from filed Forms 990 to examine the sources and uses of funds by charities and the relationship between spending and charitable work. The IRS first selected a group of about 170 smaller organizations for examination, and these examinations led to the revocation of exempt status in some cases, as well as assessing tax on unrelated business income and adjusting employment tax returns. In 2013, the IRS plans to change its focus to medium to large organizations, particularly those that report a high amount of fundraising income but much lower fundraising expenses.

### **Unrelated Business Income Tax (I.R.C. § 512(b)(13)) Study**

This ongoing study is mandated by a provision of the Pension Protection Act of 2006, requiring a report on the administration of I.R.C. § 512(b)(13), which concerns payments between controlled entities.

During the last two years, the IRS has developed a checksheet specific to this code section to be used in examinations and has compiled about 3,000 checksheets. It will continue to review those in 2013 to assemble a report.

### **Mortgage Foreclosure Assistance**

Last year, the IRS began focusing on organizations that propose to offer foreclosure assistance activities. The IRS found that many of these new organizations claiming to offer credit counseling support either did not respond when asked to show how their activities would meet the requirements of

§ 501(c)(3) or withdrew their applications for exempt status. The IRS has identified about 280 existing organizations that offer these types of services, and it plans to conduct compliance check reviews, which may lead to examinations.

#### **Self-Declarers**

Section 501(c)(4), (5), and (6) organizations that may self-declare themselves tax-exempt are the subject of an ongoing project developed by the IRS in 2012. In 2013, the IRS plans to send out a questionnaire to organizations that identified themselves as "self-declared" on Forms 990 filed in 2010 or 2011 to determine whether these organizations have classified themselves properly.

#### **Employment Tax Compliance**

In 2013, the IRS will complete its three-year study of employment tax compliance. The IRS has examined about 6,500 returns filed by exempt organizations in 2008 through 2010 for employment tax issues, and it will examine another 2,500 returns in 2013 to complete its research.

#### **International Activities**

The IRS will shift its focus to organizations with high amounts of foreign grant expenditures in 2013 after examining a sampling of organizations reporting foreign bank accounts in 2012. In addition, the IRS plans to continue its examination of selected returns of private foundations with overseas activity and of charities that participate in "gifts-in-kind" programs with domestic or foreign organizations.

#### **Group Rulings**

In 2012, the IRS released the **Group Rulings Questionnaire** and mailed the questionnaire to over 2,000 randomly selected exempt organizations in early 2013. The IRS will focus on collecting and reviewing the results of this questionnaire this year.

#### **Conclusion**

The 2013 Workplan serves as a helpful guide to the issues the IRS considers important and the initiatives that it plans to pursue in the coming year. All exempt organizations should review the Workplan and their past federal tax filings for issues that may be particularly relevant to their organizations and that may make the organization a target for the IRS enforcement activities in the upcoming year.

\* \* \* \* \*

For more information, please contact **Matthew Journey**, **Margaret Rohlfing** (DC Bar Admission Pending), **George Constantine** or **Jeffrey Tenenbaum**.

*This article is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can only be provided in response to a specific fact situation.*