TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Tax Cuts and Jobs Act: Assessment of Implementation Planning Efforts for the Excise Tax on Excess Compensation Paid by Tax-Exempt Organizations

June 5, 2019

Reference Number: 2019-14-032

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:
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TAX CUTS AND JOBS ACT: ASSESSMENT OF IMPLEMENTATION PLANNING EFFORTS FOR THE EXCISE TAX ON EXCESS COMPENSATION PAID BY TAX-EXEMPT ORGANIZATIONS

Highlights

Final Report issued on June 5, 2019

Highlights of Reference Number: 2019-14-032 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

On December 22, 2017, the President signed into law the Tax Cuts and Jobs Act of 2017, which imposes a new 21 percent excise tax on applicable tax-exempt organizations that pay more than $1 million in remuneration to any covered employee for any taxable years beginning after December 31, 2017. Implementation of the new excise tax provision requires changes to tax forms, instructions, and information technology systems as well as additional guidance to assist taxpayers to accurately report the excise tax.

WHY TIGTA DID THE AUDIT

This audit was initiated to provide a status of the IRS's progress in implementing tax law changes required by the Tax Cuts and Jobs Act. This audit assessed the actions taken by the IRS Tax Exempt and Government Entities (TE/GE) Division and the Office of Chief Counsel to effectively implement the excise tax provision.

WHAT TIGTA FOUND

The TE/GE Division coordinated with other IRS offices and developed an action plan that identified the steps needed for the implementation of the excise tax provision. The TE/GE Division also identified the affected tax forms, instructions, and information technology systems and made accurate, complete, and timely requests for revisions. The revised tax forms were available to affected taxpayers by the end of Calendar Year 2018.

In addition, the TE/GE Division coordinated with the Office of Chief Counsel to identify formal guidance needed for the excise tax provision. Although there were delays, the Office of Chief Counsel released formal guidance to the public on December 31, 2018.

Exempt Organizations employees received training on the new excise tax, and IRS officials participated in various public speaking events that included presentations about the excise tax.

However, TE/GE Division management has not completed a strategy to address noncompliance with the new tax. Although TE/GE Division management acknowledged the need for a compliance strategy and took preliminary steps in that process, as of December 31, 2018, they had not established a timeline for further development and implementation of compliance activities. Affected organizations will begin reporting the excise tax on returns filed as early as May 2019. A fully developed compliance strategy is needed to monitor and track potential noncompliance with the new excise tax.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, TE/GE Division, complete a compliance strategy to identify and bring into compliance organizations that fail to pay the excise tax.

In their response, IRS management agreed with our recommendation.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

June 5, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Tax Cuts and Jobs Act: Assessment of Implementation Planning Efforts for the Excise Tax on Excess Compensation Paid by Tax-Exempt Organizations (Audit #201810427)

This report presents the results of our review to determine if the Internal Revenue Service (IRS) is effectively implementing the excise tax on excess compensation of tax-exempt organization employees that was imposed by the Tax Cuts and Jobs Act of 2017.[1] This review is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Implementing the Tax Cuts and Jobs Act and Other Tax Law Changes.

Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. If you have any questions, please contact me or Deann Baiza, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations).

[1] Pub. L. No. 115-97. Officially known as "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for Fiscal Year 2018."

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Abbreviations

I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
TCJA	Tax Cuts and Jobs Act
TE/GE	Tax Exempt and Government Entities
TRIO	Tax Reform Implementation Office

Background

On December 22, 2017, the President signed into law the Tax Cuts and Jobs Act (TCJA) of 2017.[1] The TCJA added Section 4960 to the Internal Revenue Code (I.R.C.), which imposes a new 21 percent excise tax on applicable tax-exempt organizations that pay more than $1 million in remuneration (*i.e.*, compensation) to any "covered employee." The excise tax applies to:

- Remuneration in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for the applicable tax year.[2]
- Any excess parachute payment paid by a tax-exempt organization to any covered employee.[3]

Generally, the excise tax applies to applicable tax-exempt organizations and their related organizations.[4] The tax is effective for taxable years beginning after December 31, 2017. Consequently, some affected tax-exempt organizations (*i.e.*, the employer) will begin reporting the excise tax on tax returns filed in Calendar Year 2019. The affected organizations will use Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code* to report and pay the excise tax. Affected organizations that are public charities will use Form 990, *Return of Organization Exempt From Income Tax,* to identify themselves as affected organizations subject to the excise tax. Affected organizations that are a private foundation will use Form 990-PF, *Return of Private Foundation*, for that purpose. These forms are to be filed by the fifteenth day of the fifth month following the end of an organization's tax year. For example, the filing due date for calendar year filers (*i.e.*, tax year ending on December 31, 2018) is May 15, 2019. The Joint

Tax-exempt organizations that pay a covered employee more than $1 million may incur a 21 percent excise tax on the excess compensation beginning in taxable years beginning after December 31, 2017.

[1] Pub. L. No. 115-97. Officially known as "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for Fiscal Year 2018."
[2] Remuneration excludes certain payments, such as amounts paid to licensed medical professionals for medical services provided, and is further defined under the Key Terms section of the report.
[3] The term "parachute payment" means any payment in the nature of compensation to (or for the benefit of) a covered employee if such payment is contingent on such employee's separation from employment with the employer.
[4] A related organization can be a tax-exempt or taxable organization.

Committee on Taxation estimates that the new excise tax will raise $1.8 billion between Fiscal Years[5] 2018 and 2027.[6]

Our analysis of Internal Revenue Service (IRS) tax data identified about 2,400 employees of tax-exempt organizations that received wages greater than $1 million for Tax Year 2012. Total wages paid to the about 2,400 employees were approximately $4 billion. Analyses showed almost 1,200 (48 percent) were employees of health care and social assistance organizations who were paid approximately $1.8 billion (47 percent) of the total salaries for all tax-exempt employees making greater than $1 million.[7] According to Tax Exempt and Government Entities (TE/GE) Division management, the excise tax will affect approximately 2,700 tax-exempt organizations in Tax Year 2018.

Key terms

The TCJA uses the following specially defined terms in the excise tax provision:

Applicable tax-exempt organizations[8] **–** Organizations exempt from income tax as described in the statute including those that are charitable, social welfare, agricultural or labor, farmer's cooperative, and political organizations as well as certain government entities.[9] Related organizations are also subject to the excise tax for remuneration paid to covered employees. A related organization is any person or governmental entity that: 1) controls, or is controlled by, the organization, 2) is controlled by one or more persons who control the organization, 3) is a supported organization during the taxable year to the organization, 4) is a supporting organization during the taxable year to the organization, or 5) establishes, maintains, or makes contributions to the associated voluntary employee's beneficiary association.

Covered employee – Any current or former employee who is one of the five highest compensated employees of the organization (regardless of income amount) for any taxable year beginning after December 31, 2016.[10] Once a person becomes a covered employee, he or she will remain a covered employee for all subsequent tax years regardless of whether the individual continues to be one of the five highest compensated employees in the organization. For example:

> *Employee A is one of the five highest compensated employees of an organization in Tax Year 2018. As a result, employee A is a covered employee for the organization for Tax*

[5] A fiscal year is any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
[6] *Estimated Budget Effects Of The Conference Agreement For H.R.1, The "Tax Cuts And Jobs Act,"* Joint Committee On Taxation, December 18, 2017, JCX-67-17.
[7] See Appendix I for details of the data sources used.
[8] I.R.C. § 4960(c)(1).
[9] As defined in I.R.C. § 501(a), I.R.C. § 521(b)(1), I.R.C. § 115(1), and I.R.C. § 527(e)(1).
[10] Although the excise tax is not applicable until Calendar Year 2018, the "covered employee" criteria begins in Calendar Year 2017.

Year 2018 and all subsequent tax years regardless of the compensation employee A receives in the subsequent tax years.

A tax-exempt organization may have many covered employees. However, the organization is only subject to the excise tax for covered employees who are paid more than $1 million during the tax year or are paid any excess parachute payment.

Remuneration – Generally refers to wages and certain other amounts required to be included in gross income. Remuneration does not include amounts paid to a licensed medical professional (including a veterinarian) for medical or veterinary services. When determining the remuneration paid to an employee, an organization must include amounts paid to the employee by any related organizations. The amount of the excise tax each related organization must pay depends on the percentage of remuneration each organization pays to the covered employee. For example:

Organization A and organization B are each an applicable tax-exempt organization. Organization B is a related organization with respect to organization A. Employee C is a covered employee of both organization A and organization B. Organization A pays employee C $1.2 million. Organization B pays employee C $800,000. The total remuneration paid to employee C is $2 million.

Both organization A and organization B are required to pay a portion of the excise tax on the $1 million in excess remuneration paid to employee C (total remuneration over $1 million). The total excise tax related to employee C is $210,000 (21 percent of the $1 million excess remuneration). Organization A paid 60 percent of employee C's total remuneration ($1.2 million / $2 million); therefore, organization A is liable for 60 percent of the excise tax, or $126,000. Organization B is liable for the remaining 40 percent of the excise tax, or $84,000.

Responsibilities for implementing and administering the Section 4960 excise tax

Several IRS offices are responsible for the implementation of the new excise tax:

Tax Reform Implementation Office (TRIO) – In January 2018, the IRS created the TRIO to oversee its implementation efforts for the new tax provisions imposed by the TCJA. The TRIO is responsible for:

- Interacting with operating divisions and the Office of Chief Counsel to ensure a smooth rollout of everything needed to implement the new tax law.
- Establishing and monitoring implementation action plans.
- Ensuring communication with external and internal stakeholders.
- Mitigating risks.

The TRIO developed the *Tax Reform Implementation Planning Tool*, a planning tool to be completed by the IRS operating divisions responsible for implementing each legislative provision.

TE/GE Division – The TE/GE Division is responsible for the implementation of the new excise tax and completion of the TRIO planning tool. The tool states that implementation of the new excise tax requires revised tax forms, instructions, and information technology programming as well as taxpayer guidance, external communications, and employee training.

Office of Chief Counsel – The Office of Chief Counsel is responsible for drafting and preparing published guidance to provide correct and impartial interpretation of the new excise tax law.

This review was performed with information obtained from the IRS National Headquarters, Communications and Liaison Office, the TRIO, the TE/GE Division's Government Entities and Shared Services Office, and the Office of the Chief Counsel, all located in Washington, D.C., during the period October 2018 through March 2019. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

Steps Were Taken to Effectively Implement the Excise Tax Provision

The TE/GE Division coordinated with other IRS offices and developed an action plan that identified the steps needed for the implementation of the excise tax provision. The TE/GE Division used the TRIO's *Tax Reform Implementation Planning Tool* to identify changes and updates needed for:

- Tax forms, instructions, and computer programming.
- Taxpayer guidance.
- External communications and employee training.

TE/GE Division management tracked progress by using the TRIO's *Tax Reform Enterprise Integrated Program Plan*, which integrates each TCJA provision's implementation planning tool template and tracks target completion dates for key implementation actions. TE/GE Division management also provided updates to its *Tax Reform Enterprise Integrated Program Plan* to the TRIO, which uploads this information on its SharePoint© site every three weeks.[11]

The TE/GE Division identified updates and changes needed for tax forms, instructions, and information technology systems

The TE/GE Division identified the tax forms, instructions, and information technology systems affected by the new excise tax provision and made accurate, complete, and timely requests for revisions. *Work Request Notifications* were timely completed and submitted to the Tax Forms and Publications Division for revisions to the affected tax forms and instructions.[12] As of December 31, 2018, the following revised documents were available on the IRS's webpage:

- Form 4720, revised to include Schedule N, *Tax on Excess Executive Compensation*, which affected organizations will use to calculate and report the excise tax.
- Instructions for Form 4720.
- Form 990, including (among other changes), addition of a line item to identify the organization as subject to the excise tax and therefore, required to file Form 4720.

[11] SharePoint is an internal website used to share and manage information and documents.
[12] The Tax Forms and Publications Division uses the *Work Request Notification* to document changes to a tax product or create a new tax product. The information from the Notification can be used to support any necessary work requested from the Information Technology organization.

- Instructions for Form 990.
- Form 990-PF, including (among other changes), addition of a line item to identify the organization as subject to the excise tax and therefore, required to file Form 4720.
- Instructions for Form 990-PF.

The TE/GE Division also timely completed and submitted work requests to the Information Technology organization for changes to IRS computer applications, such as adding new data fields for Forms 990 and 990-PF. We did not assess the Information Technology organization's efforts to implement changes to IRS computer systems and programming as a result of the new excise tax. The Treasury Inspector General for Tax Administration conducted a separate review of the status of the Information Technology organization's progress in making system modifications required by the TCJA for the 2019 Filing Season.[13]

Final regulations were delayed, but interim guidance was issued on December 31, 2018

The TE/GE Division, in coordination with the Office of Chief Counsel, determined that additional published guidance was required for the new excise tax provision to assist taxpayers in accurately computing the new tax. The IRS and the Department of the Treasury develop an annual Priority Guidance Plan, which identifies issues that will be addressed in published guidance during the business plan year. Treasury's 2017–2018 Priority Guidance Plan includes "guidance on certain issues relating to the excise tax on excess remuneration paid by applicable tax-exempt organizations under Section 4960."

As of December 31, 2018, the IRS had issued proposed regulations and interim guidance related to the excise tax. The IRS released proposed regulations, *Notice of Proposed Rulemaking*, to the public on November 7, 2018, specifying the tax return to use to pay the excise tax and the time for filing the return.[14] The public was asked to provide comments on the proposed regulations by December 7, 2018. The IRS had initially planned to release the proposed regulations for public comment by August 24, 2018. The final regulation, which was initially scheduled for release on December 28, 2018, was released on April 9, 2019.[15]

The Office of Chief Counsel publically released interim guidance to assist taxpayers in applying the new excise tax on December 31, 2018.[16] The interim guidance addresses stakeholder issues

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[13] Treasury Inspector General for Tax Administration, Ref. No. 2018-24-064, *A Shortened Delivery Cycle, High Volume of Changes, and Missed Deadlines Increase the Risk of a Delayed Start of the 2019 Filing Season* (Sept. 2018).
[14] 83 Federal Register 55653, *Regulations To Prescribe Return and Time for Filing for Payment of Section 4960, 4966, 4967, and 4968 Taxes and To Update the Abatement Rules for Section 4966 and 4967*.
[15] 84 Federal Register 14008, *Regulations To Prescribe Return and Time for Filing for Payment of Section 4960, 4966, 4967, and 4968 Taxes and To Update the Abatement Rules for Section 4966 and 4967*.
[16] Notice 2019-09, *Interim Guidance Under Section 4960*.

such as who qualifies as a covered employee and what constitutes medical and veterinary services. The IRS planned to issue this interim guidance by the end of September 2018. However, Office of Chief Counsel management advised us that, during various review stages, there were recommended changes requiring discussion and revisions to the draft interim guidance notice that caused milestone dates to be missed.

The TE/GE Division trained employees and communicated with the public

In September 2018, the TE/GE Division provided web-based training to all Exempt Organizations employees as well as Compliance, Planning, and Classification function revenue agents and analysts.[17] The training covered the new excise tax provision, explained how to calculate the excise tax, and reviewed the changes to forms and instructions affected by the excise tax. The TE/GE Division is also in the process of updating the Internal Revenue Manual[18] to include the new excise tax provision and converting it into a Technical Resource Guide[19] that will be available to the public on IRS.gov.

Throughout Calendar Year 2018, IRS management proactively explained the excise tax provision at various public speaking events, such as the *IRS Nationwide Tax Forums*, the TE/GE Division Council's Exempt Organizations meeting, and various tax conferences. In addition, guidance related to the excise tax was posted on the IRS's Tax Reform webpage on IRS.gov.

A Strategy Is Needed to Address Noncompliance With the Excise Tax

As of December 31, 2018, TE/GE Division management has not completed a compliance strategy to identify and address noncompliance with the excise tax after the organizations file their returns. A fully developed compliance strategy is needed to monitor and track potential noncompliance with the new excise tax. For example, during Fiscal Year 2017, the IRS examined approximately 3,000 applicable tax-exempt organization returns[20] (0.2 percent of the

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[17] Exempt Organizations employees included Determinations and Examinations personnel, revenue agents, tax examiners, tax compliance officers, and all managers. Compliance Planning and Classification is within the TE/GE Division but not the Exempt Organizations function.

[18] The Internal Revenue Manual is the primary official source of IRS instructions to staff related to the organization, administration, and operation of the IRS. This manual details the policies, delegations of authorities, procedures, instructions, and guidelines for daily operations for all business units of the IRS.

[19] IRS management plans to convert the Internal Revenue Manual into a Technical Resource Guide, which will contain guidance regarding exempt organization laws.

[20] IRS Statistics of Income data for examined tax-exempt returns filed using Form 990; Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*; Form 990-N, *Electronic Notice for Tax Exempt Organizations*; Form 990-PF, Form 1041-A, *U.S. Information Return Trust Accumulation of Charitable Amounts*; Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*; Form 5227, *Split-Interest Trust Information Return*; and Form 4720.

average returns filed annually).[21] Because so few applicable tax-exempt organization returns are examined, it is important that the IRS effectively identifies potential noncompliance.

The Government Accountability Office *Standards for Internal Control in the Federal Government* requires organizations to prepare a compliance strategy to determine what internal controls are necessary to design, implement, and operate to achieve objectives, such as compliance with applicable laws and regulations.[22] TE/GE Division management acknowledged the need for a compliance strategy to address potential noncompliance with the new excise tax requirements. As noted previously, the IRS did make an effort to identify the population of tax-exempt organizations that may be affected. However, TE/GE Division management indicated that they believe it is too early to develop a compliance strategy for identifying noncompliant return filings.

According to management, most of the larger organizations to whom the excise tax will apply file extensions for time to file a return (the earliest return due date with an extension is November 2019). However, TE/GE Division management could not provide us with support showing that most of the larger organizations file this extension. Even if most of these organizations file for an extension, not all of them will do so. At least some of the filers affected by the new excise tax will file returns by May 2019 (the earliest return due date for reporting the new excise tax).

The IRS could begin developing a compliance strategy for identifying noncompliant filings before it starts receiving returns. For example, processes could be developed now using available filing data, such as Form W-2, *Wage and Tax Statement*s, Form 990, and Form 990-PF, to identify organizations that had covered employees who were paid more than $1 million beginning in Calendar Year 2017 (the date the covered employee criteria went into effect). The employers of these covered employees may be required to pay the excise tax if these covered employees are paid more than $1 million in remuneration for tax years beginning after December 31, 2017. In addition, because the IRS knows where information will be available on the returns filed by tax-exempt organizations (*e.g.*, the location on Form 990 where covered employees are listed), computer programming to identify potential noncompliance could be preliminarily developed and tested.

TE/GE Division's Compliance, Planning, and Classification function is responsible for overseeing the development of the compliance strategy. This process includes submitting an idea through an Issue Submission Portal and assigning it to an Issue Development Specialist, who reviews the submission and associated research and develops a compliance strategy, if possible. The submission for the excise tax provision was entered into the portal in ******2****** The request to develop a compliance strategy had been assigned to an Issue

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[21] On average, 1.5 million tax-exempt organization returns are filed annually. The number of returns examined is not specific to any fiscal year and may include prior years' returns.

[22] Government Accountability Office, GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014).

Development Specialist as of ********2******** but there was no associated timeline for further development of the strategy.

Although the IRS had not fully developed an excise tax compliance strategy as of December 31, 2018, TE/GE Division management indicated that the TE/GE Division plans to complete internal data analyses to identify noncompliance rather than request a computer programming change to systemically identify noncompliance.

Recommendation

Recommendation 1*:* The Commissioner, TE/GE Division, should complete a compliance strategy to identify and bring into compliance organizations that fail to pay the excise tax.

> ***Management's Response:*** The IRS agreed with this recommendation and indicated it would take the following actions with respect to the section 4960 excise tax compliance strategy:
>
> - Revise Forms 990 and 4720 to elicit and capture taxpayer section 4960 data.
> - Revise Instructions for Forms 990 and 4720 to provide information taxpayers need to comply with their obligation to report and pay the section 4960 excise tax.
> - Research other IRS data sources to identify the population of taxpayers potentially affected by the section 4960 excise tax.
> - Add section 4960 compliance issues into the TE/GE Division Issue Submission Portal.
> - Prepare an educational letter and obtain approval of the letter by the TE/GE Division executive Compliance, Planning, and Classification Governance Board, for issuance to potentially affected taxpayers in advance of May 15, 2019 (the earliest due date for Forms 990 and 4720 for Tax Year 2018). The IRS noted that this was completed April 26, 2019.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine if the IRS is effectively implementing the excise tax on excess compensation of tax-exempt organization employees that was imposed by the TCJA.[1] To accomplish this objective, we:

I. Determined the process used to implement the excise tax provision.

   A. Obtained and reviewed any documents, strategies, or plans related to implementing the tax.

      1. Assessed whether the IRS identified all actions necessary to implement the tax.

      2. Determined if the IRS has established appropriate mitigation strategies if project delivery dates are not met timely.

   B. Determined whether the IRS adequately coordinated the impact of the new tax across business units.

      1. Determined the planned process used by the IRS to monitor the implementation of the tax.

      2. Determined the process used by the IRS to communicate the status of the implementation of the excise tax across the agency.

   C. Determined whether taxpayer guidance related to the excise tax is adequate, timely, and accurate.

      1. Identified which tax forms, instructions, and publications are affected by the tax.

      2. Determined the time frames for revising tax forms, instructions, and publications and assessed whether the IRS will be able to issue timely guidance.

      3. Reviewed revised forms, instructions, and publications for accuracy and completeness.

[1] Pub. L. No. 115-97.

II. Determined whether the IRS is providing key services to assist tax-exempt organizations with adhering to the new excise tax provision and whether communications (internal and external) related to the excise tax were sufficient, timely, and accurate.

A. Assessed steps taken to notify potentially affected tax-exempt organizations about the tax and their filing requirements.

B. Obtained and reviewed any internal employee training or guidance (*i.e.*, Internal Revenue Manual[2] updates and Technical Resource Guides) and determined if it was sufficient and accurate.

III. Determined if the IRS is prepared to assess whether tax-exempt organizations are complying with the new tax law.

A. Determined if any strategies had been developed to address noncompliance.

B. Determined if any programming changes were needed to enable IRS systems to identify if affected tax-exempt organizations are complying with the excise tax.

C. Used prior TIGTA analysis of IRS tax data to identify the number of employees of tax-exempt organizations that received wages greater than $1 million for Tax Year 2012. We used the Exempt Organizations Master File to identify the current tax-exempt organizations as of September 2013. The employer identification numbers were then matched to the following Tax Year 2012 files:

- The Form W-2 File to identify wages paid by the tax-exempt organizations to individuals.
- The Business Master File to identify the tax-exempt organizations that filed a Form 990 in order to obtain the tax-exempt organizations' reported revenue.
- The Information Returns Master File to extract Miscellaneous Income (Form 1099-MISC) nonemployee compensation reported by the tax-exempt organizations.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the IRS's policies and

[2] The Internal Revenue Manual is the primary official source of IRS instructions to staff related to the organization, administration, and operation of the IRS. This manual details the policies, delegations of authorities, procedures, instructions, and guidelines for daily operations for all business units of the IRS.

procedures for identifying legislative changes that affect the IRS and tax administration. We also evaluated controls to provide oversight to the implementation of the TCJA provision for excise tax on excess compensation of tax-exempt organization employees. We accomplished this by interviewing IRS management, reviewing the Internal Revenue Manual, and reviewing key system documentation related to the tracking of the tax provisions in the TCJA.

Appendix II

Major Contributors to This Report

Deann Baiza, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Carl Aley, Director
Cheryl Medina, Audit Manager
Jennifer Burgess, Lead Auditor
Donald Martineau, Auditor

Appendix III

Report Distribution List

Deputy Commissioner for Operations Support
Deputy Commissioner for Services and Enforcement
Commissioner, Tax Exempt and Government Entities Division
Chief Counsel
Chief, Communications and Liaison
Director, Office of Audit Coordination

Appendix IV

Management's Response to the Draft Report

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

May 8, 2019

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Sunita B. Lough *Sunita Lough*
Commissioner,
Tax Exempt and Government Entities Division (TE/GE)

SUBJECT: Draft Audit Report – Tax Cuts and Jobs Act: Assessment of the Implementation Planning Efforts for the Excise Tax on Excess Compensation Paid by Tax-Exempt Organizations (Audit # 201810427)

Thank you for the opportunity to review the draft audit report titled "Tax Cuts and Jobs Act: Assessment of the Implementation Planning Efforts for the Excise Tax on Excess Compensation Paid by Tax-Exempt Organizations (Audit # 201810427)." You undertook the audit to review the status of the implementation of section 13602 of An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, commonly known as the Tax Cuts and Jobs Act (TCJA), which added new section 4960 to the Internal Revenue Code, effective for tax years beginning after December 31, 2017.

TIGTA noted TE/GE's "accurate, complete, and timely" actions to revise tax forms, provide guidance to potentially affected taxpayers, and educate employees. TIGTA acknowledges that effective use of the *Tax Reform Implementation Planning Tool* developed by the Tax Reform Implementation Office (TRIO) and coordination with other IRS offices resulted in the timely release of interim guidance, revised tax forms and instructions, as well as the recent release of final regulations on April 9, 2019. TIGTA also acknowledges that TE/GE trained its employees on the implementation of the new excise tax and that IRS officials participated in a number of public programs to discuss the new tax laws enacted by the TCJA.

TE/GE believes that compliance strategies relating to section 4960 enforcement are on track for a timely implementation. Development and implementation of a compliance strategy is a multi-step process.

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Compliance depends upon information provided by taxpayers. In that sense, TE/GE's compliance efforts began when it undertook to revise Forms 990 and 4720. Compliance considerations were integral to the development of the forms used to capture the data to support a compliance initiative. TIGTA acknowledges that the form revisions occurred promptly.

In June 2018, TE/GE researched additional data sources relevant to section 4960 compliance. This research helped TE/GE identify the likely population of affected taxpayers.

TE/GE submitted a compliance issue through its compliance portal in September 2018. This submission contemplated both "pre-filing education" and a post-filing "selection strategy." On April 26, 2019, TE/GE sent 3,955 educational letters to potentially affected taxpayers. The educational letter apprised taxpayers that they may need to report and pay the section 4960 excise tax.

Regarding the audit rate, the TE/GE FY2017 accomplishments letter reported that 6,101 exempt organization examinations were completed. Tax compliance is a priority for us.

We appreciate the opportunity to review and comment on the draft report. Attached is a detailed response to your recommendation regarding the implementation of a compliance strategy. If you have any questions, please contact me, or a member of your staff may contact Eric San Juan, Senior Technical Advisor to the Commissioner, at 202-317-8400.

Attachment

Attachment

Corrective Actions for TIGTA Draft Audit Report –
Tax Cuts and Jobs Act: Assessment of
Implementation Planning Efforts for the Excise Tax on
Excess Compensation Paid by Tax-Exempt Organizations (Audit # 201810427)

RECOMMENDATION 1:
The Commissioner, TE/GE Division, should complete a compliance strategy to identify and bring into compliance organizations that fail to pay the excise tax.

CORRECTIVE ACTION:
TE/GE agrees to the following actions with respect to the section 4960 excise tax compliance strategy:

1. Revision of Forms 990 and 4720, to elicit and capture taxpayer section 4960-specific data.
2. Revision of Instructions for Forms 990 and 4720, to provide information taxpayers need to comply with their obligation to report and pay the section 4960 excise tax.
3. Research of other IRS data sources to identify the population of taxpayers potentially affected by the section 4960 excise tax.
4. Addition of section 4960-specific compliance issues into the TE/GE Issue Submission Portal.
5. Preparation of an educational letter, and approval of the letter by the TE/GE executive CP&C Governance Board, for issuance to potentially affected taxpayers in advance of May 15, 2019 (the earliest due date for Forms 990 and 4720 for the 2018 tax year) – Completed 4/26/2019.

IMPLEMENTATION DATE:
October 15, 2019

RESPONSIBLE OFFICIAL(S):
Director, Government Entities/Shared Services (GE/SS), Tax-Exempt and Government Entities (TE/GE) Division

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