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TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



*Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law*

**January 6, 2020**

**Reference Number: 2020-10-001**

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:**

2 = Law Enforcement Techniques/ Procedures and Guidelines for Law Enforcement Investigations or Prosecutions.

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## HIGHLIGHTS

### **MANY ORGANIZATIONS ARE NOT NOTIFYING THE INTERNAL REVENUE SERVICE OF THEIR INTENT TO OPERATE UNDER INTERNAL REVENUE CODE SECTION 501(c)(4) AS REQUIRED BY LAW**

## Highlights

**Final Report issued on January 6, 2020**

Highlights of Reference Number: 2020-10-001 to the Commissioner of Internal Revenue.

### **IMPACT ON TAXPAYERS**

On December 18, 2015, the President signed into law the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), requiring Internal Revenue Code (I.R.C.) Section 501(c)(4) organizations to notify the IRS of their existence within 60 days of establishment. The PATH Act also includes the assessment of penalties on late filers and nonfilers and, in some cases, on the officials responsible for filing the notification. Implementation of the new notification requirement involved development of new forms and changes to information technology systems as well as new guidance to help taxpayers comply with the notification requirement.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated to assess the IRS's efforts to implement the PATH Act provision imposing a new notification requirement for certain I.R.C. Section 501(c)(4) tax-exempt organizations.

### **WHAT TIGTA FOUND**

The IRS has not taken sufficient actions to identify noncompliant I.R.C. Section 501(c)(4) organizations despite having various sources of information that would allow it to do so. Once an organization notifies the IRS of its existence, the IRS can use this information to enforce filing compliance of the required annual return.

TIGTA identified 9,774 organizations that were potentially required to file a notification but did not. These organizations and their responsible

officials were potentially subject to assessment of more than \$48.4 million and \$47.5 million in delinquency penalties, respectively. However, many of these organizations may not have understood or even been aware of the notification requirement because many of them filed other documents that informed the IRS of their existence.

The IRS recently began assessing delinquency penalties on organizations that file their notifications untimely, but it did not assess penalties on organizations that were untimely prior to February 2019. TIGTA identified 1,719 organizations that filed untimely notifications before the IRS started assessing the penalty. These organizations and the responsible officials were potentially subject to more than \$4.8 million and \$3.1 million in delinquency penalties, respectively. However, some of these organizations may have reasonable cause for filing untimely notifications and may not be subject to the penalty.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the Exempt Organizations function determine the feasibility of working with State Governments to identify new organizations required to file a notification with the IRS; conduct research on organizations identified by TIGTA and determine if any compliance actions are necessary; use available information to enforce compliance of notification requirements; determine if untimely filers had reasonable cause for filing untimely or if assessing delinquency penalties is warranted; and update notices and procedures to fully implement the law.

In their response, IRS management agreed to use available information to enforce compliance and update notices and procedures. The IRS did not agree to work with State Governments, take actions to bring organizations identified by TIGTA into compliance, and determine the applicability of penalties for untimely filers.

Notwithstanding the IRS's disagreement with certain recommendations, TIGTA believes that the recommended actions would improve the detection of noncompliant activity and ensure more consistency in how the IRS enforces the law on similarly situated organizations.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

January 6, 2020

**MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE**

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law (Audit # 201910011)

This report presents the results of our review to assess the Exempt Organizations function's efforts to implement the Protecting Americans From Tax Hikes Act of 2015<sup>1</sup> provision imposing a new notification requirement for certain Internal Revenue Code Section 501(c)(4) tax-exempt organizations. This review was part of our Fiscal Year 2019 Annual Audit Plan and addresses the major management and performance 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 V.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Heather Hill, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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<sup>1</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).



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## *Abbreviations*

EO	Exempt Organizations
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
PATH Act	The Protecting Americans From Tax Hikes Act of 2015



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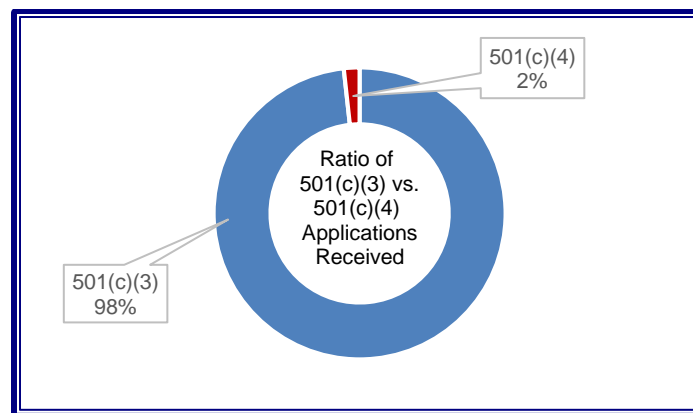
*Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law*

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## *Background*

Internal Revenue Code (I.R.C.) Section (§) 501(c)(4) organizations, commonly known as social welfare organizations, are not required to apply for tax-exempt status to operate as a tax-exempt entity, but they often do in order to provide donors with a level of assurance that they are legitimate.<sup>1</sup> The House Committee on Ways and Means learned that the Internal Revenue Service (IRS) spends thousands of hours each year reviewing voluntarily filed I.R.C. § 501(c)(4) applications for tax-exempt status, while thousands of I.R.C. § 501(c)(3)<sup>2</sup> applications, for which a determination decision is statutorily required, are not expeditiously processed.<sup>3</sup> The committee wanted to provide an alternative method that I.R.C. § 501(c)(4) organizations could use to receive a written IRS acknowledgment of their self-declared tax-exempt status.<sup>4</sup> Figure 1 illustrates the volume of applications received in Fiscal Year<sup>5</sup> 2018 by the two organization types discussed above. The IRS also receives applications for tax-exempt status from other types of organizations every year.

**Figure 1: Number of Applications for Tax-Exempt Status Received in Fiscal Year 2018 by Type [501(c)(3) and 501(c)(4)]**



Source: *Exempt Organizations (EO) management report data.*

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<sup>1</sup> There are two types of I.R.C. § 501(c)(4) organizations: social welfare organizations and local associations of employees. Social welfare organizations can include homeowner associations and volunteer fire companies.

<sup>2</sup> I.R.C. § 501(c)(3) organizations include charitable, religious, educational, scientific, and literary organizations.

<sup>3</sup> H. Rept. 114-71, *IRS Bureaucracy Reduction and Judicial Review Act* (April 2015).

<sup>4</sup> Historically, I.R.C. § 501(c)(4) organizations filed a Form 990 series return (exempt organizations information returns) to self-declare their tax-exempt status rather than apply for tax-exempt status.

<sup>5</sup> See Appendix IV for a glossary of terms.



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On December 18, 2015, the President signed into law the Protecting Americans From Tax Hikes Act of 2015 (PATH Act), which imposed a new notification requirement for I.R.C. § 501(c)(4) organizations.<sup>6</sup> An I.R.C. § 501(c)(4) organization must, no later than 60 days after the date the organization is established, notify the IRS that it is operating as an I.R.C. § 501(c)(4) organization. Per the PATH Act, Treasury Regulation § 1.506-1,<sup>7</sup> and related Revenue Procedure 2016-41,<sup>8</sup> the notification must include the following information:

- Name of the organization.
- Address of the organization.
- Employer Identification Number of the organization.
- Date of organization.
- State or other jurisdiction of organization.
- Organization's statement of purpose (social welfare or local association of employees).
- Month the organization's annual accounting period ends.

To implement this new notification requirement, the IRS developed Form 8976, *Notice of Intent to Operate Under Section 501(c)(4)*, for organizations to submit electronically via the IRS website.<sup>9</sup> This new form became available for use on July 8, 2016.

An existing I.R.C. § 501(c)(4) organization with a date of organization on or before July 8, 2016, had to submit a completed Form 8976 by September 6, 2016, unless it met one of the following as of July 8, 2016:

- Applied for tax-exempt status under I.R.C. § 501(c)(4) using Form 1024, *Application for Recognition of Exemption Under Section 501(a)*.
- Filed at least one annual information return or notice (Form 990, *Return of Organization Exempt From Income Tax*; Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*; or Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990-EZ*).

A user fee of \$50 must be sent within 14 days of submitting Form 8976. Forms received without payment are rejected, and a letter is mailed directly to the organization. If the submission is rejected for another reason, *e.g.*, invalid Employer Identification Number, the user fee is

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<sup>6</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).

<sup>7</sup> Treas. Reg. § 1.506-1, *Organizations required to notify Commissioner of intent to operate under section 501(c)(4)*.

<sup>8</sup> IRS, Revenue Procedure 2016-41, 2016-30 I.R.B. 165, 26 CFR 1.506, *Requirement to notify the IRS of intent to operate as a section 501(c)(4) organization* (July 25, 2016).

<sup>9</sup> IRS, *Electronically Submit Your Form 8976, Notice of Intent to Operate Under Section 501(c)(4)*.





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refunded and the organization may have to submit a new Form 8976 and user fee to meet the notification requirement.<sup>10</sup>

Revenue Procedure 2016-41 requires the IRS to assess a penalty on organizations for untimely filing or nonfiling of Form 8976. Untimely filers are assessed a delinquency penalty of \$20 per day up to \$5,000. Nonfiler organizations are similarly penalized until they file their Forms 8976, up to a maximum of \$5,000. The IRS may notify nonfilers of their noncompliance and provide a deadline for filing Form 8976. If the deadline is missed, the person or persons responsible for filing Form 8976 will also be penalized \$20 per day up to \$5,000, starting after the due date on the notice. The IRS may grant relief from a penalty if an organization establishes to the satisfaction of the IRS that the failure to timely submit the Form 8976 was due to reasonable cause. For example, foreign organizations, small organizations, and organizations that originally operated under sections other than section 501(c)(4) may seek reasonable cause relief.

The number of I.R.C. § 501(c)(4) applications for tax-exempt status filed has declined in recent years. Applications dropped 44 percent from 3,357 in Fiscal Year 2012 to 1,896 in Fiscal Year 2015 (the last full fiscal year before organizations were required to start submitting Form 8976). Furthermore, Figure 2 shows that applications filed continued to decline after the IRS implemented the Form 8976 notification requirement. In addition, submission of Form 8976 has increased each year since the requirement began.

**Figure 2: Number of Applications for Tax-Exempt Status and Notifications Received**

Fiscal Year	I.R.C. § 501(c)(4)	Form 8976 Notifications <sup>11</sup>
2016	1,869	1,451
2017	1,555	2,255
2018	1,552	3,284

Source: EO management report and Form 8976 submission data.

Congress intended for this notification requirement to reduce the number of I.R.C. 501(c)(4) organizations filing voluntary applications for tax-exempt status so the IRS could focus on processing applications from organizations required to file one. However, this recent decrease is less than the percentage decrease that occurred during the four fiscal years prior to the implementation of the PATH Act. Although the number of I.R.C. § 501(c)(4) organizations that

<sup>10</sup> Some notifications are rejected because the organizations already filed an application for tax-exempt status or a Form 990 series return and are not required to file a Form 8976.

<sup>11</sup> These totals include multiple submissions from some organizations that had their Forms 8976 rejected, so the organization refiled a corrected one.



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submitted an application for tax-exempt status decreased by 17 percent between Fiscal Years 2016 and 2018, we are unable to determine if the decrease was a result of the new notification requirement. External influences, such as election cycles and natural disasters, affect the number of applications for tax-exempt status the IRS receives each year.

This review was performed at the EO function Determinations Unit in Cincinnati, Ohio, and with information obtained from the Submission Processing Programs Unit in the Government Entities and Shared Services function in Ogden, Utah, during the period August 2018 through July 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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*Results of Review*

**Thousands of Organizations May Be Unaware of Their Requirement to File Form 8976**

Organizations that file voluntary applications for I.R.C. § 501(c)(4) tax-exempt status demonstrate a desire to receive recognition as a tax-exempt entity from the IRS. Organizations that have filed the required Form 990 series return also show a willingness to be compliant with their filing responsibilities. However, thousands of these organizations did not file a required Form 8976. Filing an application for tax-exempt status and/or a Form 990 series return after July 8, 2016, does not alleviate the Form 8976 notification requirement.<sup>12</sup> In addition, we identified thousands of organizations that did not file an application for tax-exempt status or a Form 990 series return and also did not file a Form 8976 even though they were potentially required to do so.

The IRS has not taken sufficient actions to identify noncompliant I.R.C. § 501(c)(4) organizations, despite having various sources of information that would allow the agency to do so. \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*

We identified 9,774 I.R.C. § 501(c)(4) organizations that were potentially required to file a Form 8976 but did not.<sup>13</sup> These organizations were potentially subject to assessment of delinquency penalties totaling more than \$48.4 million.<sup>14</sup> In addition, responsible officials associated with these organizations may also have been subject to assessment of additional

<sup>12</sup> Notice 2016-09, *Section 506 Notification Requirement for New and Certain Existing Section 501(c)(4) Organizations*.

<sup>13</sup> Between early 2014 and July 2015, whenever a nonprofit organization applied for an Employer Identification Number, account research was performed to determine if another Employer Identification Number had already been assigned to the entity, and if not, an account was created for the entity based on the organization's name. IRS management stated that, if the organization's name sounded like a church, it was given Status Code 30; organizations whose names did not sound like a church were given Status Code 36 and identified as I.R.C. § 501(c)(4) organizations. This practice likely incorrectly coded thousands of organizations as I.R.C. § 501(c)(4) on IRS systems, but the IRS was unable to determine which ones are miscoded.

<sup>14</sup> As of September 30, 2018. The total consists of delinquency penalties totaling \$40,895,000 and \$7,591,780, respectively, that should be assessed against 8,179 I.R.C. § 501(c)(4) organizations that existed as of July 8, 2016, and 1,595 I.R.C. § 501(c)(4) organizations formed after July 8, 2016.



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delinquency penalties totaling more than \$47.5 million.<sup>15</sup> However, many of these 9,774 tax-exempt organizations may not have understood or even been aware of this notification requirement.

**More information is needed to enforce Form 8976 notification requirements**

Prior to the PATH Act, the IRS did not have a process to proactively identify newly established I.R.C. § 501(c)(4) organizations and therefore relied on these organizations to voluntarily notify the IRS of their establishment. The PATH Act requires organizations to notify the IRS of their intent to operate as an I.R.C. § 501(c)(4) exempt organization no later than 60 days after their establishment, regardless of whether they have already notified the IRS by another type of filing, *e.g.*, an application for tax-exempt status. This notification must provide certain information, including the date an organization was established. Additional guidance explained that this notification is accomplished by the filing of Form 8976. Organizations established on or before July 8, 2016, were also required to file Form 8976 unless they met certain exceptions previously discussed.<sup>16</sup>

Revenue Procedure 2016-41 defines the date of organization in relation to the I.R.C. § 501(c)(4) notification requirement as the date on which the organization was formed as a legal entity. Generally, the date of organization refers to the date the charter or articles of incorporation (hereafter referred to as organizing documents) were approved by the appropriate State. For unincorporated organizations, the date refers to the date the constitution or articles of association were created. The IRS will not approve an I.R.C. § 501(c)(4) application for tax-exempt status without a copy of its filed organizing documents. Some States' websites provide access to copies of the approved organizing documents, while others provide search capabilities to identify registered nonprofits.

However, the IRS does not receive any information, including organizing documents, from the States or the organizations (unless they file an application for tax-exempt status) to alert it about a newly established organization that is required to file a Form 8976. EO function management is unaware of any information exchanges with State Governments that would provide the needed information to enforce the Form 8976 notification requirement. As a result, the IRS cannot proactively enforce the Form 8976 notification requirement with the limited information available unless a newly established I.R.C. § 501(c)(4) organization makes the IRS aware of its existence through other mechanisms, such as if it applies for tax-exempt status or files a Form 990 series return with the IRS.

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<sup>15</sup> As of September 30, 2018. We allotted the IRS 30 days after the Form 8976 due date to issue the demand to file notice to the organization. We then determined the total penalties that could be assessed to responsible officials at the rate of \$20 per day after the demand notice due date.

<sup>16</sup> The PATH Act included an enactment date of December 18, 2015, but due to the time it took to implement this notification requirement, the Department of the Treasury updated this date to July 8, 2016, in its regulations.



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**The EO function should take additional steps to identify, notify, and enforce notification compliance**

The IRS has not taken sufficient actions to identify noncompliant I.R.C. § 501(c)(4) organizations despite having possible sources of information that would facilitate this. The IRS's Fiscal Year 2018 – 2022 Strategic Plan states that one of the IRS's key responsibilities is to ensure that taxpayers comply with the tax law. According to the IRS Strategic Plan, the agency plans to develop innovative approaches to understand, detect, and resolve potential noncompliance to keep taxpayer confidence in the tax system strong. We have identified several actions the EO function can take to identify I.R.C. § 501(c)(4) organizations that have not filed Form 9970 as required.

- Identify Form 9970 nonfilers with a known tax-exempt status – Although it is not required, some organizations file an application for recognition of exemption under I.R.C. § 501(c)(4) and pay the associated \$600 fee. Determinations specialists that review these applications could also verify that the organizations have filed the required Forms 9970. Although filing a Form 9970 is not required to receive recognition of tax-exempt status, a reminder notice could be issued to those organizations that have not complied with the notification requirement. We identified 883 organizations that filed an application after July 8, 2016, but did not file a Form 9970 as required. During this audit, EO function Determinations Unit management stated that this process is “theoretically workable,” but ensuring that organizations filed Forms 9970 is unrelated to the primary responsibility of Determinations Unit specialists, which is to timely determine if organizations qualify for tax-exempt status.
- Review rejected Form 9970 notifications – Prior to voluntarily filing for I.R.C. § 501(c)(4) tax-exempt status with the IRS, organizations are required to file their organizing documents with their applicable State Governments to establish themselves as nonprofit organizations. This establishes their intent to operate, which starts the 60-day statutory requirement for notifying the IRS of their existence. An organization files its Form 9970 via the IRS's website. If the notification does not meet all requirements, a Determinations Unit tax examiner rejects it and sends a notice to the organization explaining the reason(s) for the rejection. It is up to the organization to refile an accurate Form 9970. However, the IRS does not follow up with the organization to enforce compliance if the organization is required to notify the IRS but does not refile a corrected Form 9970. We determined that 946 (84 percent) of 1,125 organizations had their Forms 9970 rejected but never filed a required corrected form that was accepted by the IRS.<sup>17</sup> EO function management stated that the IRS does not monitor whether the filer

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<sup>17</sup> As of September 30, 2018. These 946 organizations are not included in the 9,774 organizations we identified from our analyses of IRS data or included in our potential delinquency penalties calculations.



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subsequently resubmits an approved Form 8976. Once the IRS issues the rejection notice, it is up to the organization to refile the Form 8976.

- Revise the notice issued to Form 8976 nonfilers – Prior to July 2016, the IRS did not issue notices to I.R.C. § 501(c)(4) tax-exempt organizations that filed an information return but did not file an application for tax-exempt status voluntarily (because they could self-declare as tax-exempt organizations).<sup>18</sup> The IRS implemented procedures in July 2016 for the issuance of a notice to I.R.C. § 501(c)(4) organizations that file a Form 990 series return but are not known to be claiming tax-exempt status (either by filing an application for tax-exempt status or a Form 8976). However, the current notice does not include information related to I.R.C. § 501(c)(4) organizations, including the Form 8976 notification requirement or the option of filing the new Form 1024-A, *Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code*, by I.R.C. § 501(c)(4) organizations.<sup>19</sup> We identified 712 organizations that filed an initial Form 990 series return after July 8, 2016, and did not file an application for tax-exempt status but did not file a Form 8976 as required.

**TIGTA identified thousands of tax-exempt organizations that did not file potentially required Forms 8976**

Using available information sources such as applications for tax-exempt status, we determined that 9,774 I.R.C. § 501(c)(4) organizations were potentially subject to assessment of delinquency penalties totaling more than \$48.4 million as of September 30, 2018, for failing to file Forms 8976.<sup>20</sup> We matched data from four different sources to identify organizations that did not file a Form 8976 but may have been required to do so.<sup>21</sup> Our analyses identified I.R.C. § 501(c)(4) organizations in IRS systems that met one of the following conditions:

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<sup>18</sup> Computer Paragraph 120 Notice, *Confirmation of Tax-Exempt Status Required*. Prior to the Form 8976 notification requirement, I.R.C. § 501(c)(4) organizations did not have to notify the IRS when they were established in order to be considered tax-exempt, but they were required to file a Form 990 series return. As such, the IRS previously did not issue notices to I.R.C. § 501(c)(4) organizations when they filed information returns but had not filed an application for tax-exempt status.

<sup>19</sup> The notice currently suggests that organizations file either a Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, or Form 1024. Beginning in January 2018, I.R.C. § 501(c)(4) organizations are required to use Form 1024-A to apply for tax-exempt status. EO function management stated that the notice is being revised and should be available in January 2020.

<sup>20</sup> To compute applicable penalties, the dates of organization are needed but were unavailable. Therefore, we substituted the dates with information that was available. Specifically, we used the date the organization filed an application for tax-exempt status or the date the organization's filed Form 990 return posted to its account when computing the related penalties. As a result, some of the calculated penalties are understated.

<sup>21</sup> We used data from the Business Master File, the EO Business Master File, the Employee Plans/Exempt Organizations Determination System, and the Form 8976 Electronic Filing System. See Appendix IV for explanations of these systems.



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- Established as of July 8, 2016, but had not filed an application for tax-exempt status or Form 990 information return. These organizations were required to file Forms 8976 but did not (8,179 organizations).
- Established after July 8, 2016, and filed a new application for tax-exempt status but did not file a Form 8976 (883 organizations).
- Established after July 8, 2016, and filed its initial Form 990 series return but did not file an application for tax-exempt status or a Form 8976 (712 organizations).<sup>22</sup>

In addition to the delinquency penalties that the IRS could assess against the organizations, the EO function could also assess separate penalties on the officials responsible for filing the Forms 8976 if the IRS does not receive a response to a notice informing the organizations about the notification requirement. We computed the applicable additional penalties that could be assessed against responsible officials for not filing the Forms 8976.<sup>23</sup> We determined that responsible officials may also have been subject to assessment of delinquency penalties totaling more than \$47.5 million as of September 30, 2018, for failure to file Forms 8976. \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*

EO function Determinations Unit management indicated that their function does not have the authority to assess penalties. Submission Processing function management stated it was outside the scope of its responsibilities. \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*

EO function management also stated that they have not initiated any compliance activities because it would be a resource-intensive process and resources would be better used in other priority areas, e.g., processing applications for tax-exempt status. In addition, management believed it was burdensome to assess penalties on these organizations because it was a new requirement and many of the organizations are small and managed by volunteers with limited knowledge of tax laws. The PATH Act allows the issuance of a notice informing the organization that it is required to file a Form 8976. However, management has not proactively notified noncompliant organizations, so they may continue to be noncompliant. As a result, newly established organizations and responsible officials could be subject to higher penalty

<sup>22</sup> These organizations were identified on IRS systems as I.R.C. § 501(c)(4) organizations prior to a procedural change. Beginning in July 2016, the EO function implemented a process to issue a Computer Paragraph 120 Notice to any I.R.C. § 501(c)(4) organization that files a Form 990 return but does not have a Form 8976 on file. These organizations are not identified as I.R.C. § 501(c)(4) organizations on IRS systems, so our analysis did not include them.

<sup>23</sup> We allotted the IRS 30 days after the Form 8976 due date to issue the demand to file notice to the organization. We then calculated the potential penalty assessment amount for responsible officials at \$20 for each day after the demand notice due date.



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amounts, up to \$5,000, because the penalty amount increases each day they remain noncompliant.

In addition, ensuring that new I.R.C. § 501(c)(4) organizations file their required Forms 8976 will improve the IRS's capability to enforce other filing compliance. Once an organization notifies the IRS of its existence via the filing of the Form 8976, the IRS can use this information to enforce filing compliance of the required annual Form 990 series return. The Form 990 series return may provide information that the IRS can use to ensure that an organization's activities still qualify it for tax-exempt status.<sup>24</sup> Prior to the Form 8976 notification requirement, the IRS was generally only aware of an I.R.C. § 501(c)(4) organization's existence if it voluntarily filed an application for tax-exempt status or Form 990 series return.<sup>25</sup>

## ***Recommendations***

The Director, EO function, should:

**Recommendation 1:** Determine the feasibility of working with State Governments to identify newly established I.R.C. § 501(c)(4) organizations. This process could include identifying electronic repositories of organizing documents kept by State Governments or developing information sharing agreements to identify Form 8976 notification noncompliance and take actions, such as issuing a notice, to bring the organizations into compliance.

**Management's Response:** The IRS disagreed with this recommendation. IRS officials have determined that it is not feasible to use State Governments' databases to identify newly established I.R.C. § 501(c)(4) organizations. State incorporation databases do not identify I.R.C. § 501(c)(4) organizations. State nonprofit corporation laws do not require conformity with I.R.C. § 501(c)(4). These databases show only that certain entities have incorporated as "nonprofits," which is no indication of exempt status under Federal income tax law. Systemically, it is not feasible to review all nonprofit charters, which may or may not describe purposes consistent with I.R.C. § 501(c)(4). Legally, such a review is beyond the scope of I.R.C. § 506, under which the IRS must acknowledge the notice submitted by the organization without determining exempt status.

**Office of Audit Comment:** We recognize current data limitations would require a labor-intensive process, which is why we recommended determining the feasibility of working with State Governments to obtain this information. The IRS did not provide us any supporting documentation for the actions taken to determine if this was feasible. In Publication 557, *Tax-Exempt Status for Your Organization*, the IRS instructs the organizations to include the subsection they will be operating under, e.g., I.R.C.

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<sup>24</sup> Form 990-N does not include detailed information, \*\*\*\*\*2\*\*\*\*\*

<sup>25</sup> Some organizations may also file other types of returns, such as employment tax returns if they have employees, which would also notify the IRS of their existence.





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*Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law*

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§ 501(c)(4), in their organizing documents, so the States should have the information the IRS needs to enforce compliance. Developing information sharing agreements with State Governments would provide the IRS access to this information. I.R.C. § 506 requires enforcing compliance with the notification requirement, which includes identifying organizations that are noncompliant.

**Recommendation 2:** Use internal sources of information, *e.g.*, applications for tax-exempt status filed after July 8, 2016, to assist with detecting I.R.C. § 501(c)(4) organizations that have not filed Forms 8976 and update EO function Determinations Unit procedures to include verifying that I.R.C. § 501(c)(4) organizations have met their Form 8976 notification requirement when processing applications for tax-exempt status. In addition, develop a process for notifying identified Form 8976 nonfiler organizations about this requirement to bring them into compliance.

**Management's Response:** The IRS agreed with this recommendation and plans to use Form 1024-A to identify potential nonfilers. The IRS will develop a process for notifying identified Form 8976 nonfiler organizations or taking other appropriate action based on the results of the checks to promote compliance with the Form 8976 submission requirement.

**Recommendation 3:** Follow up with those organizations that were required to file notifications but had their initial Forms 8976 rejected and never refiled.

**Management's Response:** The IRS disagreed with the recommendation but will continue to send to organizations Letter 5823, *Rejection of Receipt of Form 8976*, which identifies the reason for rejection.

**Office of Audit Comment:** As we previously stated, I.R.C. § 506 requires enforcing compliance with the notification requirement, which includes identifying organizations that are noncompliant. Based upon our review of the Form 8976 filing data, we concluded that 946 organizations whose notifications the IRS rejected should have resubmitted the Form 8976. By initially filing a notification, these organizations identified themselves as active I.R.C. § 501(c)(4) entities. We excluded from our analysis organizations whose notifications the IRS rejected because they were not required to file a Form 8976, so they did not need to resubmit one.

In addition, because the IRS is not proactively attempting to bring these organizations into compliance, any assessed delinquency penalties will be higher than if the organizations were brought into compliance earlier. For example, if an organization never resubmits a rejected Form 8976 but later files a Form 990, the IRS will request that the entity submit the required notification. Once the notification is accepted by the IRS, it will assess a daily delinquency penalty, up to \$5,000, on the organization. By delaying compliance efforts, the IRS has increased the penalty burden on the organization. Not following up with organizations that never refile a rejected Form 8976 is a missed



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opportunity to bring these organizations into compliance with the law earlier in the process.

**Recommendation 4:** Revise the Computer Paragraph 120 Notice to include information about the Form 8976 notification requirement and the Form 1024-A application for I.R.C. § 501(c)(4) organizations.

**Management's Response:** The IRS agreed with this recommendation and will revise the Computer Paragraph 120 Notice to include information about the Form 8976 notification requirement and the Form 1024-A application for I.R.C. § 501(c)(4) organizations.

**Recommendation 5:** Conduct appropriate research for the 9,774 nonfiler I.R.C. § 501(c)(4) organizations we identified as of September 30, 2018, to determine if any actions are necessary, including informing the taxpayer of the notification requirement or assessing delinquency penalties if warranted.

**Management's Response:** The IRS disagreed with this recommendation. IRS officials have already conducted research indicating that our audit report significantly overstated the number of potential nonfiling organizations. Specifically, 601 organizations' tax-exempt status should have been revoked prior to the legislation requiring a Form 8976. An additional 7,274 entities were categorized in IRS records as I.R.C. § 501(c)(4) organizations at a time when nearly all nonprofits that requested an Employer Identification Number were categorized as such, not just I.R.C. § 501(c)(4) organizations.

The IRS shares the concern with identifying delinquent filers and implemented systemic programming that identifies Form 8976 late filers. Because the IRS has completed these actions, no additional actions are planned at this time until the results of the systemic programming are evaluated.

**Office of Audit Comment:** IRS records showed the 601 entities as active organizations, not revoked. According to the IRS's own analysis, these organizations were not systemically revoked because the established revocation criteria did not identify the accounts for revocation. IRS management surmised that the accounts probably did not include a Form 990 filing requirement. Based on the status of these 601 organizations on IRS systems as of September 30, 2018, they were active and required to file a notification.

Between early 2014 and about July 2015, the IRS classified all nonprofit entities requesting an Employer Identification Number as I.R.C. § 501(c)(4) organizations unless the name of the organization sounded like a church. IRS management stated that this practice resulted in an overstatement of the number of I.R.C. § 501(c)(4) organizations in IRS records. However, the IRS could not identify which of the 7,274 entities were correctly coded as I.R.C. § 501(c)(4) organizations and which were miscoded. Based on



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the classifications in IRS systems, these 7,274 organizations are required to file a notification.

**Recommendation 6:** Update EO function examination procedures to include ensuring that I.R.C. § 501(c)(4) organizations have met their Form 8976 notification requirement and assessing penalties against responsible officials when appropriate.

**Management's Response:** The IRS agreed with this recommendation and plans to update EO function examination procedures.

### **Systemic Assessments Were Not Made on All Noncompliant Organizations**

The IRS only began assessing penalties on I.R.C. § 501(c)(4) organizations that filed untimely Forms 8976 received by the IRS on or after February 28, 2019.<sup>26</sup> Per I.R.C. § 6652(c)(4)(A), the IRS should assess a penalty on organizations for untimely filing or nonfiling of Form 8976 at \$20 per day, up to \$5,000. Between February 28 and May 23, 2019, the IRS penalized 102 organizations more than \$350,000 for untimely filing their Forms 8976. However, the IRS did not penalize thousands of organizations that untimely filed a Form 8976 prior to February 28, 2019. This resulted in the inequitable treatment of taxpayers by penalizing some organizations and not others.

Tax Exempt and Government Entities Division leadership made a business decision to assess penalties for untimely filed Forms 8976 when it could be done systemically. This did not occur until February 2019. EO function management stated that limited funding and resources as well as time constraints affected program development and delayed implementation. Moreover, EO function management concluded that the retroactive penalty assessments would have to be completed manually, and they did not have the staffing to do it. In addition, many people that were involved in the decisions on how to implement the notification requirement are no longer IRS employees, so current EO function management is unsure why some decisions were made.

We analyzed all Form 8976 filing data as of September 30, 2018, to determine how many organizations filed untimely forms and computed the applicable penalties. We identified 1,719 organizations that untimely filed their Forms 8976 and were potentially subject to more than \$4.8 million in delinquency penalties. The responsible officials related to these 1,719 untimely filed Forms 8976 were potentially subject to an additional \$3.1 million in penalties. Approximately 5 percent (84 of the 1,719 organizations) had filed an application for tax-exempt status prior to filing the Form 8976. In addition, some of the 1,719 late filers may have reasonable cause for filing untimely notifications and may not be required to pay a penalty.

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<sup>26</sup> Computer Paragraph 215, *Notice of Penalty Charge*. Due to the Federal Government shutdown that began in December 2018, the implementation of this programming was delayed. It was originally planned for January 2019.



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## **Recommendation**

The Director, EO function, should:

**Recommendation 7:** Determine if the I.R.C. § 501(c)(4) organizations that filed untimely Forms 8976 prior to February 28, 2019, had reasonable cause for filing untimely or if assessing delinquency penalties is warranted.

**Management's Response:** The IRS disagreed with this recommendation. The IRS shares the concern with identifying delinquent filers, now addressed through systemic programming applicable to all Forms 8976 going forward. According to IRS management, it would be resource intensive to assess penalties and review requests for reasonable cause abatement. The IRS exercises its discretion in allocating resources to priority areas and does not believe voluntary compliance would be enhanced by retroactively applying penalties to the introductory years of legislation that has no tax consequence.

**Office of Audit Comment:** Penalties are manually assessed by the IRS in many situations, and organizations that file untimely Forms 8976 are now systemically identified and potentially assessed the penalty. The IRS is not enforcing the law consistently on similarly situated organizations.

## **Form 8976 Rejection Notices May Contain Conflicting Information**

The IRS issues a notice when it rejects a Form 8976 filing. A Determinations Unit tax examiner composes the notice by selecting prewritten paragraphs that describe why the Form 8976 was rejected. However, some notices may contain conflicting information if the Determinations Unit tax examiner selects prewritten paragraphs from the Form 8976 Electronic Filing System with contradictory language to explain the reasons why the Form 8976 was rejected. For example, the two prewritten paragraphs below could be included in a rejection letter and contain contradictory information that could cause taxpayer confusion if a filer unnecessarily submitted Form 8976 and did not pay the user fee at the time of filing.

*You're not required to submit Form 8976 because you submitted a Form 990 series return or a Form 1024 requesting a determination of your exempt status prior to the enactment of the Notice requirement.*

*We can't process your Form 8976 because your user fee did not successfully process. You will need to re-submit your Form 8976 and correct user fee.*

The first paragraph informs the filer that the Form 8976 does not need to be filed, but the second paragraph instructs the filer to pay the user fee when the Form 8976 is resubmitted.

Determinations Unit tax examiners are required to include all reasons why the Form 8976 was denied when composing the rejection notice that is sent to the filer, even if the standard



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paragraphs are contradictory. This requirement originated from the processing procedures for Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, which requires Determinations Unit tax examiners to provide a reason for each condition that caused the application rejection.<sup>27</sup> The employees responsible for processing Forms 1023-EZ also process Forms 8976 and follow these same procedures. The IRS has rejected 1,208 Forms 8976 submitted by 1,125 organizations as of September 30, 2018.<sup>28</sup> These organizations may have received confusing notices with contradictory information. Furthermore, 946 (84 percent) of 1,125 organizations that had their Forms 8976 rejected never filed a corrected one that was accepted by the IRS.<sup>29</sup> Management does not track whether these organizations should have refiled their Forms 8976. The conflicting rejection reasons make it difficult to differentiate between organizations that are responsible for refiled the form and those that do not have to file.

EO function management stated that there is no indication of confusion by taxpayers. Management stated that they were not aware of any resubmissions of Forms 8976 based upon contradictory paragraphs. Management also stated that the taxpayer call center has not received any requests from taxpayers for clarification on Form 8976 rejection notice wording, but they based this claim on anecdotal feedback from call site assistors. Incoming calls are not coded or categorized for this particular issue, so actual data are not available. Because they are not aware of any cases of taxpayer confusion, EO function management does not consider this an issue needing correction.

## ***Recommendation***

**Recommendation 8:** The Director, EO function, should update procedures to ensure that Determinations Unit tax examiners do not include conflicting information in notices when the filer is informed about why a Form 8976 was rejected, *e.g.*, develop additional standard paragraphs that would eliminate possible confusion.

**Management's Response:** The IRS agreed with this recommendation and plans to update EO function Determinations Unit procedures.

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<sup>27</sup> Internal Revenue Manual 7.20.9, *Processing Form 1023-EZ*.

<sup>28</sup> Some organizations made multiple Form 8976 filings that the IRS rejected.

<sup>29</sup> As of September 30, 2018.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to assess the EO function's efforts to implement the PATH Act provision imposing a new notification requirement for certain I.R.C. Section (§) 501(c)(4) tax-exempt organizations.<sup>1</sup> To accomplish our objective, we:

- I. Determined the procedures for filing and processing Forms 8976, *Notice of Intent to Operate Under Section 501(c)(4)*.
  - A. Interviewed Determinations Unit employees to identify the process for filing and reviewing Forms 8976.
  - B. Obtained and reviewed all procedures and guidance for filing and processing Forms 8976. This included ensuring that all necessary information is obtained to implement the requirements in the legislation.
- II. Determined if I.R.C. § 501(c)(4) organizations organized on or before July 8, 2016, filed Forms 8976 as required.<sup>2</sup>
  - A. Obtained the necessary data to identify I.R.C. § 501(c)(4) organizations that had not filed a Form 8976 as required.
  - B. Identified 8,179 I.R.C. § 501(c)(4) organizations that may have been required to file a Form 8976 and computed penalties that potentially should have been assessed.
- III. Determined if I.R.C. § 501(c)(4) organizations organized after July 8, 2016, filed Forms 8976 as required.
  - A. Performed queries on the Employee Plans/Exempt Organizations Determination System<sup>3</sup> data to identify organizations that filed an application for tax-exempt status after July 8, 2016.
  - B. Matched the results of Step III.A. to the Form 8976 filing data and identified 883 organizations that did not file a Form 8976 as required.

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<sup>1</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).

<sup>2</sup> Organizations that did not file an application for tax-exempt status or a Form 990 series return or notice on or before July 8, 2016, were required to file a Form 8976.

<sup>3</sup> See Appendix IV for a glossary of terms.



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- C. Using the results of Step III.B., determined if the organizations are more than 60 days old by researching the Employee Plans/Exempt Organizations Determination System data.
  - D. Using the results of Step III.C., computed the daily delinquency penalty for organizations more than 60 days old.
  - E. Matched the Business Master File data to the Form 8976 filing data to identify organizations that have filed an information return, *i.e.*, Form 990, *Return of Organization Exempt From Income Tax*, but have not filed a Form 8976.
  - F. Using the results of Step III.E., computed the daily delinquency penalty for 712 organizations that have filed an information return but not a Form 8976 after July 8, 2016.
- IV. Evaluated the planned process for assessing penalties for untimely filed Forms 8976 and making reasonable cause waiver determinations.
- A. Interviewed Determinations Unit and Submission Processing function personnel to identify the planned process for assessing penalties for untimely filed Forms 8976 and making reasonable cause penalty waiver determinations.
  - B. Queried the Form 8976 filing data to identify organizations that filed untimely.
  - C. Calculated the daily delinquency penalty that should have been assessed using the data from the Form 8976 Electronic Filing System for 1,719 organizations that filed Form 8976 late.
  - D. Obtained and reviewed Unified Work Requests and any resulting programming documentation to ensure that taxpayer accounts were properly updated with information from the Form 8976 Electronic Filing System so penalties would be properly assessed once implemented.

**Validity and reliability of data from computer-based systems**

We performed tests to assess the reliability of data from the following systems:

- Business Master File – We determined that the data were reliable for our purposes by conducting electronic data testing for missing data, outliers, or obvious errors.
- EO Business Master File – We determined that the data were reliable for our purposes by conducting electronic data testing for missing data, outliers, or obvious errors.
- Employee Plans/Exempt Organizations Determination System – We determined that the data were reliable for our purposes by conducting electronic or manual data testing for missing data, outliers, or obvious errors.



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- Form 8976 Electronic Filing System – We determined that the data were reliable for our purposes by conducting electronic or manual data testing for missing data, outliers, or obvious errors.

**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: requests for Master File updates in order to assess penalties, computer programming to identify untimely filed Form 8976, and procedures for assessing penalties for untimely filed Forms 8976. We evaluated these controls by interviewing EO function and Submissions Processing function personnel, reviewing work requests for the development of the Form 8976, and reviewing procedures for assessing penalties.





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**Appendix II**

*Major Contributors to This Report*

Deann Baiza, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Heather Hill, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Carl Aley, Director

Cheryl Medina, Audit Manager

Michael McGovern, Auditor



*Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law*

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## **Appendix III**

### *Report Distribution List*

Deputy Commissioner for Services and Enforcement  
Commissioner, Tax Exempt and Government Entities Division  
Director, Exempt Organizations, Tax Exempt and Government Entities Division  
Director, Enterprise Audit Management



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**Appendix IV**

*Glossary of Terms*

Term	Definition
Business Master File	The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.
Employee Plans/ Exempt Organizations Determination System	Maintains inventory for cases being resolved under the Employee Plans Determination Letter Program and the Exempt Organizations Determination Letter Program. It also contains letter generation functionality for the determination letter.
Exempt Organizations Business Master File	The IRS's computer system for all organizations that have had an application for tax exemption processed. The system is also updated for returns received, examination results, <i>etc.</i>
Fiscal Year	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.
Form 8976 Electronic Filing System	This online registration system allows organizations that intend to operate under I.R.C. § 501(c)(4) to submit Form 8976, <i>Notice of Intent to Operate Under Section 501(c)(4)</i> . This system also enables filers to receive secure, digital communications from the IRS.
Unified Work Request	A process that provides a common framework to document, control, monitor, and track requests for changes to IRS computer systems and for support.



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**Appendix V**

*Management's Response to the Draft Report*




TAX EXEMPT AND  
GOVERNMENT ENTITIES DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

December 6, 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Tamera L. Ripperda   
Commissioner  
Tax-Exempt and Government Entities Division (TE/GE)

RE: Draft Audit Report – Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) as Required by Law (Audit # 2020-10-001, job code 201910011)

Thank you for the opportunity to review the referenced report. You undertook the audit to assess the Internal Revenue Service's (IRS's) implementation of the notification requirement of Internal Revenue Code (IRC) § 506 enacted in the Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, div. Q.

Under IRC § 506, organizations can "self-declare" § 501(c)(4) social welfare status through submitting the required notification and receive IRS acknowledgment of the notification. The legislative history states: "The Committee therefore believes it is desirable to eliminate the need for a section 501(c)(4) organization that desires written IRS acknowledgment of its exempt status to apply for a formal IRS determination by requiring all organizations organizing under the section to provide the IRS with notice of existence and requiring the IRS to provide timely acknowledgment of that notice." H. Rep. No. 114-71 at 8 (2015). Thus, the legislation relieved taxpayer burden on obtaining the acknowledgement – imposing neither an application requirement nor an income tax consequence.

We share an interest in effective implementation of tax legislation. Accordingly, the IRS built the electronic platform for filing thousands of the newly created Forms 8976; issued thousands of acknowledgements; and published four pieces of legal guidance, in the form of Notice 2016-09, Rev. Proc. 2016-41, proposed and temporary regulations (81 Fed. Reg. 45,088; TD 9775), and final regulations (TD 9873). The IRS timely established the processes and systems needed to implement the notification requirement.



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TIGTA's report focuses on the IRS's efforts to identify noncompliant IRC § 501(c)(4) organizations and asserts that many organizations are not submitting the notification as required. The draft report overstates by as much as 81% the number of organizations that potentially failed to submit Form 8976, *i.e.* 7,875 organizations. The draft report counts as potential non-submitters 7,274 entities categorized in "Status 36" in 2014-15, a systemic code applied at that time to almost all non-profits that requested an Employer Identification Number (EIN), not just IRC § 501(c)(4) organizations. See IRS Pub. 55-B, *Data Book* (2014) pg. 58, Table 25, Special Notice, <https://www.irs.gov/pub/irs-soi/14databk.pdf>; see also IRM 21.3.8.9.12 (May 31, 2019). The draft report also includes 601 entities whose tax-exempt status would have been automatically revoked by operation of law before the effective date of the legislation for failing to file required annual information returns or notices for three consecutive years. See IRC § 6033(j).

Beyond overstating the universe of potential non-filers, the report's estimates of associated penalties are theoretical. TIGTA acknowledges that reasonable cause exceptions may apply, and penalties on managers would be possible in the first instance only if the organization did not submit the Form 8976 within a specified period after a demand was issued. Moreover, IRS Policy Statement 20-1 says: "Penalties are used to enhance voluntary compliance." IRM 1.2.1.12.1 (June 29, 2004). Management exercises its discretion in allocating resources to other priority areas of noncompliance, such as processing applications for tax-exempt status. Furthermore, it is unclear how voluntary compliance would be enhanced by retrospectively applying penalties to organizations that may be small and managed by volunteers with limited knowledge of tax laws.

The IRS shares the concern for identifying delinquent submitters and promoting awareness of the IRC § 506 reporting requirement. Accordingly, the IRS agrees to update correspondence that it sends to organizations that have not filed applications for recognition of exemption or annual information returns to include information about the Form 8976 requirement.

The IRS also agrees that it will utilize internal documents, specifically Forms 1024-A, *Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code*, to identify potential non-filers. In identifying potential non-filers, the IRS must use accurate information to find them. The draft report suggests research in State incorporation data-bases, but these do not identify § 501(c)(4) organizations. State non-profit corporation laws do not require conformity with IRC § 501(c)(4). State data-bases will show only that certain entities have incorporated as "non-profits," which is no indication of exempt status under Federal income tax law. Systemically, it is not feasible to review all non-profit charters, which may or may not describe purposes consistent with § 501(c)(4). Legally, such a review is beyond the scope of IRC § 506, under which IRS must acknowledge the notice submitted by the organization without determining exempt status.



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We appreciate the opportunity to review and comment on the draft report. Attached is a detailed response to the recommendations. If you have any questions, please contact me, or a member of your staff may contact Margaret A. Von Lienen, Director, Exempt Organizations and Government Entities, at (513) 975-6562.

Attachment



*Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law*

Attachment

**Corrective Actions for TIGTA Draft Audit Report –  
Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent  
to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law  
(Audit # 2020-10-001)**

**RECOMMENDATION 1:**

The Director, EO function, should determine the feasibility of working with State Governments to identify newly established I.R.C. § 501(c)(4) organizations. This process could include identifying electronic repositories of organizing documents kept by State Governments or developing information sharing agreements to identify Form 8976 notification noncompliance and take actions, such as issuing a notice, to bring the organizations into compliance.

**CORRECTIVE ACTION:**

The IRS has determined that it is not feasible to use State Governments' databases to identify newly established IRC § 501(c)(4) organizations and therefore disagrees with this recommendation as noted in the management response.

**IMPLEMENTATION DATE:**

N/A

**RESPONSIBLE OFFICIAL(S):**

N/A

**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 2:**

The Director, EO function, should use internal sources of information (e.g., applications for tax-exempt status filed after July 8, 2016) to assist with detecting I.R.C. § 501(c)(4) organizations that have not filed Forms 8976 and update EO Determinations Unit procedures to include verifying that I.R.C. § 501(c)(4) organizations have met their Form 8976 notification requirement when processing applications for tax-exempt status. In addition, develop a process for notifying identified Form 8976 non-filer organizations about this requirement to bring them into compliance.

**CORRECTIVE ACTION:**

The IRS agrees to use Form 1024-A, Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code, to identify potential non-filers. The IRS will develop a process for notifying identified Form 8976 non-filer organizations or taking other appropriate action based on the results of the checks to promote compliance with the Form 8976 submission requirement.

**IMPLEMENTATION DATE:**

March 15, 2021



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**RESPONSIBLE OFFICIAL(S):**

Director, Exempt Organizations and Government Entities, Tax Exempt and Government Entities Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 3:**

The Director, EO function, should follow up with those organizations that were required to file notifications but had their initial Forms 8976 rejected and never refiled.

**CORRECTIVE ACTION:**

The IRS disagrees with the recommendation but will continue to send to organizations the Letter 5823, Rejection of Receipt of Form 8976, which identifies the reason for rejection.

**IMPLEMENTATION DATE:**

N/A

**RESPONSIBLE OFFICIAL(S):**

N/A

**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 4:**

The Director, EO function, should revise the Computer Paragraph 120 Notice to include information about the Form 8976 notification requirement and the Form 1024-A application for I.R.C. § 501(c)(4) organizations.

**CORRECTIVE ACTION:**

The IRS agrees with this recommendation and will revise the Computer Paragraph 120 Notice to include information about the Form 8976 notification requirement and the Form 1024-A application for I.R.C. § 501(c)(4) organizations.

**IMPLEMENTATION DATE:**

June 15, 2020

**RESPONSIBLE OFFICIAL(S):**

Director, Exempt Organizations and Government Entities, Tax Exempt and Government Entities Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.





*Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law*

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**RECOMMENDATION 5:**

The Director, EO function, should conduct appropriate research for the 9,774 non-filer I.R.C. § 501(c)(4) organizations we identified as of September 30, 2018, to determine if any actions are necessary, including informing the taxpayer of the notification requirement or assessing delinquency penalties if warranted.

**CORRECTIVE ACTION:**

As noted in the Management Response, IRS has already conducted research indicating that TIGTA has significantly overstated the number of potential non-filing organizations. IRS shares the concern with identifying delinquent filers and has created systemic programming that is now in place and identifies late filers of Form 8976. Since IRS has completed these actions, no additional actions are planned at this time until the results of the systemic programming are evaluated.

**IMPLEMENTATION DATE:**

N/A

**RESPONSIBLE OFFICIAL(S):**

N/A

**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 6:**

The Director, EO function, should update EO examination procedures to include ensuring that I.R.C. § 501(c)(4) organizations have met their Form 8976 notification requirement and assessing penalties against responsible officials when appropriate.

**CORRECTIVE ACTION:**

The IRS agrees with this recommendation to update EO Examination procedures.

**IMPLEMENTATION DATE:**

March 15, 2021

**RESPONSIBLE OFFICIAL(S):**

Director, Exempt Organizations and Government Entities, Tax Exempt and Government Entities Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 7:**

The Director, EO function, should determine if the I.R.C. § 501(c)(4) organizations that filed untimely Forms 8976 prior to February 28, 2019, had reasonable cause for filing untimely or if assessing delinquency penalties is warranted.



*Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law*

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**CORRECTIVE ACTION:**

The IRS shares the concern with identifying delinquent filers, now addressed through systemic programming applicable to all Forms 8976 going forward. It would be resource-intensive to assess penalties and review requests for reasonable cause abatement. Management exercises its discretion in allocating resources to priority areas and does not believe voluntary compliance would be enhanced by retrospectively applying penalties to the introductory years of legislation that has no tax consequence; therefore, the IRS disagrees with this recommendation.

**IMPLEMENTATION DATE:**

N/A

**RESPONSIBLE OFFICIAL(S):**

N/A

**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 8:**

The Director, EO function, should update procedures to ensure that Determinations tax examiners do not include conflicting information in notices when the filer is informed about why a Form 8976 was rejected (e.g., develop additional standard paragraphs that would eliminate possible confusion).

**CORRECTIVE ACTION:**

The IRS agrees with this recommendation to update EO Determinations procedures.

**IMPLEMENTATION DATE:**

March 15, 2021

**RESPONSIBLE OFFICIAL(S):**

Director, Exempt Organizations and Government Entities, Tax Exempt and Government Entities Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.