

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



Procedural Changes and Training Could Improve the Processing of Proposed Denied Applications for Tax Exemption

December 19, 2022

Report Number: 2023-10-004

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.

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HIGHLIGHTS: Procedural Changes and Training Could Improve the Processing of Proposed Denied Applications for Tax Exemption

Final Audit Report issued on December 19, 2022

Report Number 2023-10-004

Why TIGTA Did This Audit

This audit was initiated at the request of 13 U.S. Senators. The overall objective of this audit was to evaluate the Tax Exempt and Government Entities Division's oversight controls and procedures when issuing proposed adverse Internal Revenue Code (I.R.C.) § 501(c)(3) tax-exempt status determination letters.

Tax law generally requires organizations to apply with the IRS for recognition as I.R.C § 501(c)(3) entities.



I.R.C. § 501(c)(3) requires an organization to be both "organized" and "operated" exclusively for exempt purposes.

Impact on Tax Administration

The Exempt Organizations Determinations (EOD) unit is responsible for reviewing applications to determine whether the organizations qualify for tax-exempt status and issuing determination letters. If the EOD specialist proposes a denial of tax exemption, organizations have a right to protest the decision. Failure to follow established procedures and document all actions taken when processing proposed denials of tax exemption could lead to case processing delays, incorrect determinations, or denials of taxpayer rights.

What TIGTA Found

Determination case files were sometimes incomplete, and employees did not always document actions taken when processing proposed and final adverse determinations. Our review of all 68 proposed adverse determination case files closed in Fiscal Year 2021 identified 40 (59 percent) case files that were missing required documents or information needed to support the actions taken by EOD specialists and Quality Assurance reviewers. For example, in 18 (26 percent) of 68 cases, EOD specialists did not document their manager's concurrence with the proposed adverse determination, as required. Due to the missing documentation, TIGTA could not always confirm that EOD specialists and Quality Assurance reviewers completed all the necessary actions to process proposed adverse determinations.

In addition, EOD management does not always effectively use Quality Measurement Process results to address identified quality issues. The Quality Measurement Process evaluates work quality in four categories of accuracy and timeliness measures. Although the overall quality score for the four categories evaluated averaged 82 percent in Fiscal Year 2021, individual attributes received far less favorable ratings. For example, Fiscal Year 2021 quarterly reports consistently indicated low scores for the "Timely Actions Taken" attribute.

Finally, EOD management has not established quantifiable goals for quality review results. Goals help measure how organizations perform relative to its past performance and shows the progress in management's efforts to improve the quality of programs.

EOD specialists, Quality Assurance reviewers, and managers received religious, civil, and Constitutional rights training on how to determine if an organization is a church and were participants in discussions about the Bill of Rights and the Civil Rights Act of 1964, including the freedom of religion and nondiscrimination based on religion.

What TIGTA Recommended

TIGTA recommended that the Director, Exempt Organizations:

- 1) ensure that EOD specialists complete, and managers review, all required actions when processing proposed denials of tax exemption;
- 2) require EOD specialists to fully document discussions with taxpayers and actions taken;
- 3) require Quality Assurance reviewers to document that applicants did not submit a protest;
- 4) provide refresher training to EOD specialists and Quality Assurance reviewers;
- 5) ensure that actions taken to address common quality deficiencies resolve the issues; and
- 6) develop baseline goals for quality review scores and adjust them periodically, as needed.

IRS management agreed with all six recommendations and plans to take corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

December 19, 2022

MEMORANDUM FOR: ACTING COMMISSIONER OF INTERNAL REVENUE

FROM:

Heather Hill

Heather M. Hill
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Procedural Changes and Training Could Improve the Processing of Proposed Denied Applications for Tax Exemption (Audit # 202210029)

The overall objective of this review was to evaluate the Tax Exempt and Government Entities Division's oversight controls and procedures when issuing proposed adverse Internal Revenue Code § 501(c)(3) tax-exempt status determination letters. This audit was conducted at the request of members of the U.S. Senate, is part of our Fiscal Year 2023 Annual Audit Plan, and addresses the major management and performance challenge of *Increasing Domestic and International Tax Compliance and Enforcement*.

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

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 Bryce Kisler, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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Background

In response to a proposed denial of tax-exempt status for a particular organization, the Treasury Inspector General for Tax Administration (TIGTA) received a request from 13 U.S. Senators asking for a review and report on the Internal Revenue Service's (IRS) current processes and procedures for making tax-exempt status determinations under Internal Revenue Code (I.R.C.) § 501(c)(3). The request also asked us to include information about training provided to determinations personnel.

Exempt Organizations Rulings and Agreements office

The Exempt Organizations/Government Entities function within the IRS's Tax Exempt and Government Entities Division includes two primary operational areas involved in tax-exempt oversight responsibilities: the Rulings and Agreements office and the Examinations unit.¹ The Exempt Organizations Rulings and Agreements office includes the Exempt Organizations Determinations (EOD) and the EOD Quality Assurance (EODQA) units. The EOD unit is responsible for reviewing applications to determine whether the organizations qualify for tax-exempt status and issuing determination letters. The EODQA unit is responsible for reviewing determination cases and advising EOD management of areas that need attention. The EODQA unit reviews determination cases to ensure:

- Technical accuracy.
- Adherence to written procedures.
- Uniform and impartial treatment of exempt organizations' interests, while protecting the Government's interest.
- Identification of unfavorable case patterns, trends affecting processing quality, problem areas, unique issues, and new or innovative techniques that EOD specialists develop.

I.R.C. § 501(c)(3)

Unless an exception applies, I.R.C. § 508 requires new organizations to notify the IRS that they are applying for recognition of I.R.C. § 501(c)(3) status.² Organizations recognized by the IRS as exempt under I.R.C. § 501(c)(3) are exempt from Federal income tax, and contributions to them may be tax deductible on the donors' tax returns. I.R.C. § 501(c)(3) requires an organization to be both "organized" and "operated" exclusively for exempt purposes. These purposes include charitable, religious, educational, scientific,

Tax law generally requires organizations to apply with the IRS for recognition as I.R.C § 501(c)(3) entities.



I.R.C. § 501(c)(3) requires an organization to be both "organized" and "operated" exclusively for exempt purposes.

¹ The Government Entities function includes the Compliance Unit, Indian Tribal Governments, Tax Exempt Bonds, and Federal, State, and Local Governments/Employment Tax functions.

² Exceptions per I.R.C. § 508(c) include churches, their integrated auxiliaries, and conventions or associations of churches, or any organization which is not a private foundation (as defined in I.R.C. § 509(a)) and the gross receipts of which in each taxable year are normally not more than \$5,000.

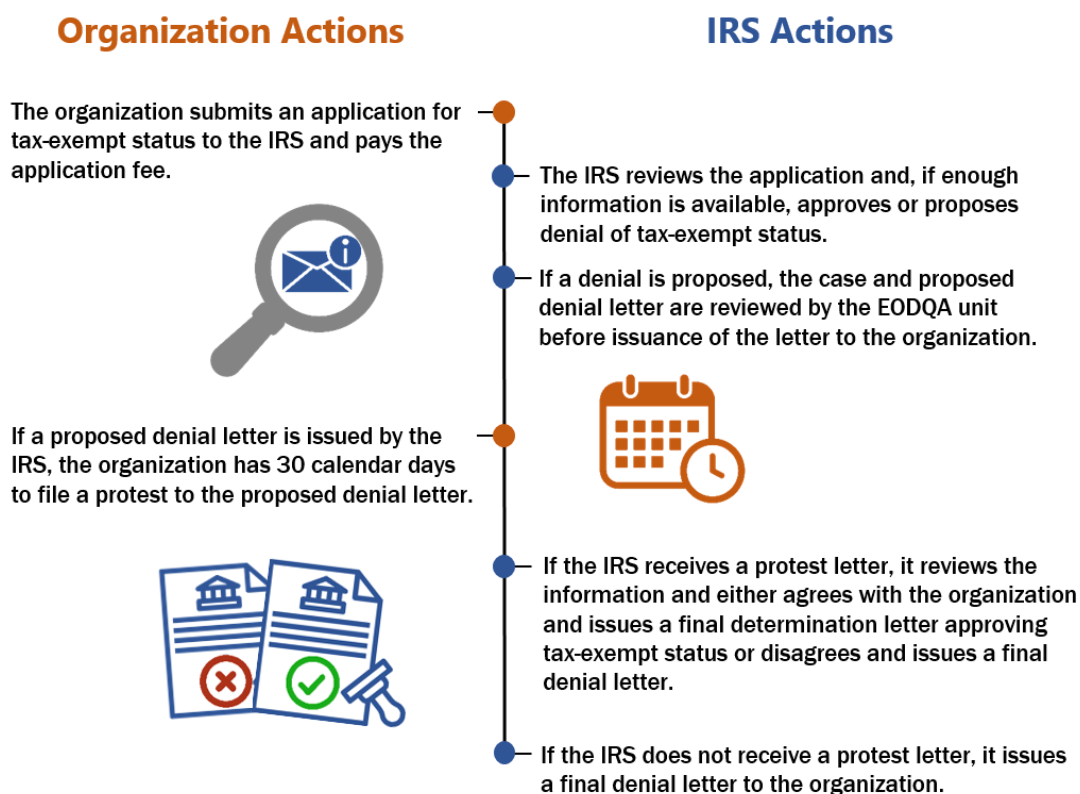
literary, testing for public safety, fostering national and international amateur sports competition, and preventing cruelty to children or animals.

Proposed adverse determinations and EODQA unit mandatory reviews

EOD specialists process applications for tax-exempt status as proposed adverse determinations when an organization has not provided sufficiently detailed information to establish that it qualifies for exemption or if the information provided establishes that it does not qualify for exemption. EOD specialists propose denials of tax-exempt status (adverse determinations), and should, after receiving concurrence from their group managers and discussing the proposed denials with the applicants, draft proposed adverse determination letters.

After the group manager reviews the case, the EOD unit should forward the case to the EODQA unit for a mandatory review prior to the issuance of the proposed adverse determination letter. The mandatory review includes reviewing the case file to confirm the EOD specialist made a reasonable effort to ensure that the organization understands the reason for the adverse ruling, that all reasonable attempts to secure information to make a determination were made, and to correct or change the proposed adverse letter, if necessary. Figure 1 illustrates the overall process for reviewing tax-exempt status determinations requests.

Figure 1: Overview of the Determinations Process

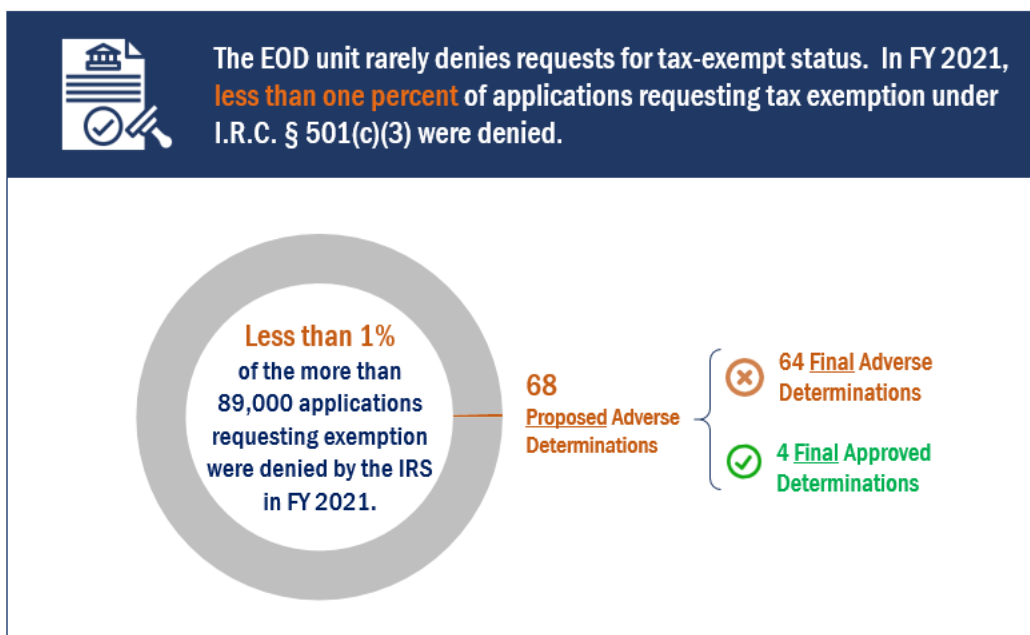


Source: Internal Revenue Manual 7.20.5 (July 20, 2021) and Revenue Procedure 2022-5 (January 3, 2022).

Procedural Changes and Training Could Improve the Processing of Proposed Denied Applications for Tax Exemption

The EOD unit rarely denies requests for tax-exempt status.³ Figure 2 compares the number of I.R.C. § 501(c)(3) applications received with those denied during Fiscal Year (FY) 2021.

Figure 2: FY 2021 Statistics for I.R.C. § 501(c)(3) Applications



Source: TIGTA review of FY 2021 closed I.R.C. § 501(c)(3) determination data and cases from the Employee Plans/Exempt Organizations Determination System.

In FY 2021, the IRS denied less than 1 percent of applications requesting tax exemption under I.R.C. § 501(c)(3). Similarly, TIGTA previously reported that from FYs 2015 through 2019, less than 1 percent of all applications filed were denied tax exemption each year, including I.R.C. § 501(c)(3) requests.⁴

Quality Measurement Process (QMP)

The EODQA unit also provides the EOD unit analytic support to measure, report, and recommend improvements in EOD program quality through its QMP. The Quality Assurance reviewers are supposed to ensure that selected case files contain properly completed documentation, including determination letters with appropriate addenda and attachments as well as forms, check sheets, and guide sheets applicable to the case. Quality Assurance reviewers should also determine whether EOD specialists obtained and developed all pertinent facts on technical issues and based the determinations on laws, regulations, published rulings, and court cases that support the findings.

³ Applications that are not approved can be closed for several reasons, including the application was returned incomplete, the organization did not respond to an information request, or the organization withdrew the application.

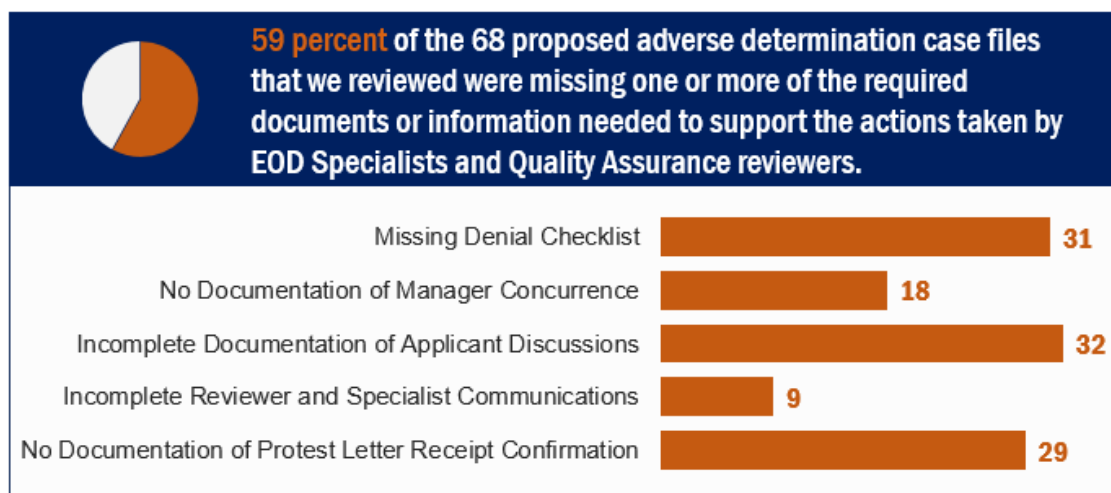
⁴ TIGTA, Report No. 2021-10-031, *Fiscal Year 2019 Statistical Trends Review of the Tax Exempt and Government Entities Division* (May 2021).

Results of Review

Determination Case Files Were Sometimes Incomplete, and Employees Did Not Always Document Actions Taken When Processing Proposed and Final Adverse Determinations

Our review of all 68 proposed adverse determination case files closed in FY 2021 identified 40 (59 percent) case files that were missing required documents or information needed to support the actions taken by EOD specialists and Quality Assurance reviewers. Due to the missing documentation, TIGTA could not always confirm that EOD specialists and Quality Assurance reviewers completed all the necessary actions to process proposed adverse determinations. Figure 3 shows the frequency of the missing or incomplete information in the case files.⁵

Figure 3: Summary of Case Review Results



Source: TIGTA review of closed FY 2021 proposed adverse determination cases.

Missing denial checklist. In 31 (46 percent) of 68 cases, the required Form 14280, *EO Determinations Checklist – Denials*, was missing. This checklist helps ensure that EOD specialists complete all required actions for a proposed denial. In addition, we determined that the form needs to be updated to reflect current procedures. For example, as of September 2020, EOD specialists are no longer required to prepare a *Special Handling Notice* when closing mandatory review cases, but the checklist still includes it as a required step.⁶ EOD management stated that they are reviewing Form 14280 to determine if the checklist is still necessary or if enhancements can be made to the form so that it is more useful.

⁵ Numbers do not reconcile to 40 because some cases can have more than one issue.

⁶ The Special Handling Notice is a form used to notify the manager and administrative personnel that information in a case file must be sent to a different area. It is also used to notify them that a case requires special action at closing.

Procedural Changes and Training Could Improve the Processing of Proposed Denied Applications for Tax Exemption

Manager concurrence. In 18 (26 percent) of 68 cases, EOD specialists did not document their manager's concurrence with the proposed adverse determination in the Case Chronology Record⁷ (hereafter referred to as the case activity log), as required by the Internal Revenue Manual.⁸ In addition, Quality Assurance reviewers could not substantiate managerial involvement in the determination as required by procedures due to this lack of documentation. Failure to obtain manager concurrence prior to discussing a potential denial of tax-exempt status with the applicant could lead to inconsistent taxpayer treatment and increased taxpayer burden if the manager later disagrees with the potential denial decision.

In addition, for 11 of the 37 case files with the required Form 14280, EOD specialists indicated that the managers' concurrences with the proposed adverse decisions were documented in the case activity logs, but the case activity logs did not include these concurrences.⁹ EOD managers are not required to review Form 14280 to ensure that EOD specialists completed all required actions.

Applicant discussions. In 32 (47 percent) of 68 cases, EOD specialists did not document their discussions of one or more procedurally required topics regarding proposed adverse determinations with the applicants. These topics include: 1) reasons for the proposed adverse determination; 2) a description of the adverse process, including any appeal rights and the appeals process; 3) any clarification of facts in the case, including activities and purposes; 4) possible alternatives to an adverse position when otherwise approving exemption, *e.g.*, an alternative foundation classification; and 5) other available options, *e.g.*, withdrawing the request.¹⁰ Figure 4 shows the number of case files that did not document discussions of the various required topics.

Figure 4: Summary of Required Topic Discussions



Source: TIGTA review of closed FY 2021 proposed adverse determination cases.

⁷ A Case Chronology Record documents the EOD specialist's actions, when actions take place, and the amount of time taken on the actions.

⁸ Internal Revenue Manual 7.20.2.4 (Aug. 10, 2021).

⁹ Out of the 68 proposed denial case files, 37 included a Form 14280 and 31 files did not.

¹⁰ None of the 68 cases reviewed required a discussion of the fourth topic - possible alternatives to an adverse position when otherwise approving exemption.

The *Taxpayer Bill of Rights* includes, *The Right to Challenge the IRS's Position and Be Heard*, which states that taxpayers have the right to provide a response to formal IRS actions or proposed actions, to expect the IRS will consider their timely objections and additional documentation, and to receive a response if the IRS does not agree with their position.¹¹

EOD management stated that requiring the discussion of these topics ensures the protection of taxpayer rights and provides consistent information to taxpayers so they understand the reasons for an adverse determination. However, although EOD specialists are required to discuss each topic, they are not required to document these discussions in detail. Instead, general procedures require EOD specialists to document all actions taken on a case, including letters prepared/mailed, responses received, telephone contacts made, significant group manager involvement, and research completed.

In addition, EODQA unit procedures require Quality Assurance reviewers to verify that the EOD specialist made a reasonable effort to ensure that the organization understands the reason for the proposed adverse determination, including verifying that the specialist called the organization to discuss it. However, EODQA unit procedures do not require Quality Assurance reviewers to confirm that the EOD specialist actually discussed the determination, only that the specialist attempted to contact the organization. For example, questions for Quality Assurance reviewers to consider include, did the EOD specialist call the organization to discuss the reasons for the proposed adverse determination, any available alternative actions, the organization's appeal rights, and the consequences of the adverse action. Meanwhile, additional procedures require the Quality Assurance reviewer to determine if the EOD specialist took more specific actions, including whether the specialist:

- Gave the organization an opportunity to amend organizational documents, proposed activities, or both, to qualify for exempt status (if appropriate based on the facts).
- Attempted to secure missing information.
- Addressed foundation status as a secondary issue in an I.R.C. § 501(c)(3) proposed adverse determination if the specialist disagrees with the requested status.

Because EOD specialists are not required to document their discussions of each required topic, Quality Assurance reviewers cannot fully comply with these procedures or ensure that specialists took all necessary actions to protect taxpayer rights and provide consistent information to taxpayers so they understand the reasons for an adverse determination. Not discussing the required topics with the taxpayer when proposing a denial of tax-exempt status could result in an improper denial based on incomplete information, which is a potential violation of the taxpayer's rights.

In addition, the EODQA unit issues quarterly reports of its analyses of mandatory review cases. In FY 2021, the mandatory quarterly reports indicated that taxpayers were not informed their applications were being denied and/or EOD specialists did not discuss the adverse ruling with their managers.

¹¹ Omnibus Taxpayer Bill of Rights, Pub. L. No. 100-647, 102 Stat. 3730 (1988) (codified as amended in scattered sections of 5 and 26 U.S.C.).

Quality Assurance reviewer and EOD specialist communications. In 15 (22 percent) of 68 cases, EOD specialists prepared, signed, and forwarded *Response to Reviewer's Memorandums* to Quality Assurance reviewers who issued memorandums with recommendations for additional research or changes to the proposed adverse determination letter. However, nine (13 percent) of the response memorandums were incomplete. Figure 5 shows the number of cases with response memorandum documentation issues.¹²

Figure 5: Summary of Response Memorandum Documentation Issues



Source: TIGTA review of closed FY 2021 proposed adverse determination cases.

Failure to provide a response to the Quality Assurance reviewer or not documenting concurrence with the EOD specialist's actions may lead to incomplete or inaccurate denial decisions as well as incomplete administrative records for determinations.

Protest letter submissions. In 29 (43 percent) of 68 cases, Quality Assurance reviewers did not document that they contacted the EOD specialists who proposed the adverse determinations to confirm the applicants did not submit a written protest. The *Taxpayer Bill of Rights* includes the right to timely object to a decision and provide documentation for consideration. Applicants have the right to protest a proposed adverse determination and submit a letter within 30 calendar days following the issuance of the letter. However, procedures do not require Quality Assurance reviewers to document their contact with the EOD specialists confirming that no protest was submitted.

EOD management stated that there may be an opportunity to require Quality Assurance reviewers to document their contacts with the EOD specialists when inquiring if a written protest was submitted by the applicant and will evaluate the procedures. If reviewers do not verify with the EOD specialists whether they received a protest prior to issuing the final adverse determination letter, there is a risk that they could deny applicants their appeal rights and create taxpayer burden.

Overall, EOD management stated that EOD specialists and Quality Assurance reviewers may need additional training because they did not follow established procedures when processing cases. Failure to follow established procedures and document all actions taken could lead to

¹² In some cases, the response memorandum was not signed by both the EOD specialist's manager and the Quality Assurance reviewer, so they are included in both counts of incomplete cases.

case processing delays, incorrect determinations, or denials of taxpayer rights. Employees should document case assignment and closing, review of the application and correspondence, research, oral and written communications with the taxpayers and their representatives as well as contact and discussion with IRS personnel in the case activity log. In addition, although the case activity log is not open for public inspection, it may be read by individuals other than IRS personnel, *e.g.*, if the case is being litigated. A case activity log could be critical if the organization is later identified as being potentially abusive or if fraud is suspected.

The Director, Exempt Organizations, should:

Recommendation 1: Ensure that EOD specialists complete Form 14280, update it to reflect current procedures, and require EOD managers to review and sign off on the form to help ensure that specialists complete all required actions.

Management's Response: The IRS agreed with this recommendation and will update Form 14280 to reflect current procedures and require managers to sign off on Form 14280 to ensure it is completed by specialists.

Recommendation 2: Revise procedures to require that EOD specialists discuss and document required topics with the applicants prior to developing proposed denial letters and require Quality Assurance reviewers to ensure that specialists have discussed each topic.

Management's Response: The IRS agreed with this recommendation and will update procedures to require that specialists document discussion of the required topics and that Quality Assurance reviewers confirm the documentation as part of their review procedures.

Recommendation 3: Update procedures to require that Quality Assurance reviewers document in their case activity logs contacts with EOD specialists to determine if protests were received prior to issuing final adverse determination letters.

Management's Response: The IRS agreed with this recommendation and will update procedures to require that Quality Assurance reviewers document case activity logs for contacts with specialists to determine if protests were received prior to issuing final adverse determination letters.

Recommendation 4: Provide refresher training on the documentation requirements for proposed adverse determination case files to EOD specialists and Quality Assurance reviewers.

Management's Response: The IRS agreed with this recommendation and will provide refresher training on the documentation requirements for proposed adverse determination case files to EOD specialists and Quality Assurance reviewers.

Exempt Organizations Determinations Management Does Not Always Effectively Use Quality Measurement Process Results to Address Identified Quality Issues

Management did not always take effective corrective actions to improve common quality issues that the EODQA unit repeatedly identified for different attributes. Although the overall quality score for the four evaluated categories averaged 82 percent in FY 2021, individual attributes received far less favorable ratings.

The EODQA unit conducts quality reviews of a sample of closed determination cases and provides quarterly reports to the EOD unit with its results through its QMP. The QMP involves performing sample reviews on four different work streams: 1) Form 1023-EZ - standard processing, 2) Form 1023-EZ - pre-determination processing, 3) Form 1023-EZ - referral processing, and 4) all other determination case processing.¹³

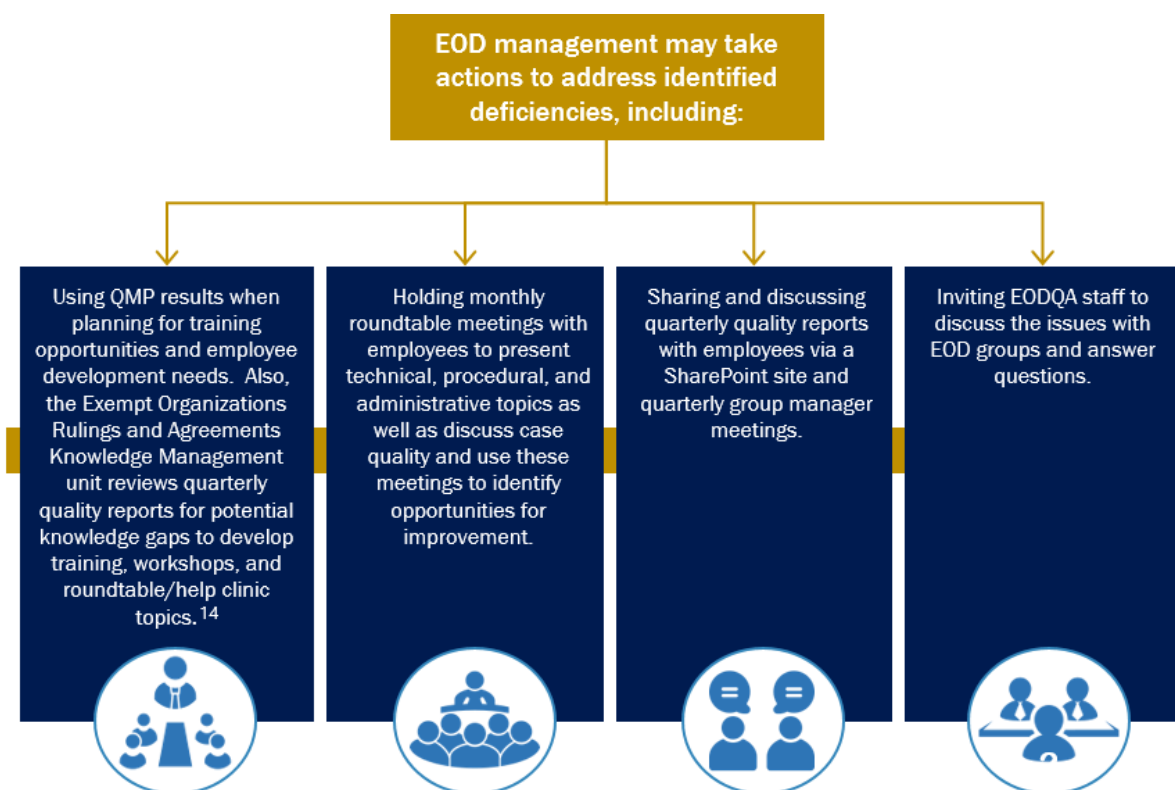
The QMP calculates EOD case processing quality scores using attributes to measure the work quality. Quality Assurance reviewers rate determination cases by answering a series of questions in a survey format. The survey contains questions that correlate to attributes that fall within one of four categories:

- Customer Accuracy.
- Procedural Accuracy.
- Regulatory Accuracy.
- Timeliness.

The system totals each attribute category and averages them to determine the quality score. The EODQA unit reports quality scores to EOD management and describes any identified trends. EOD management may then take actions to address deficiencies identified. Figure 6 shows actions that EOD management may take in response to the quality reports.

¹³ Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.

Figure 6: Examples of EOD Management Actions



Source: EOD management.

However, actions taken by management in response to QMP results are not always effective and do not always improve the quality of cases. The QMP sometimes repeatedly identifies the same deficiencies despite management potentially taking one or more actions to address them. For example, Figure 7 shows that the FY 2021 quarterly reports consistently indicated low scores for the “Timely Actions Taken” attribute.

¹⁴ Knowledge Management is a method that captures, shares, and applies employee knowledge to enhance learning, performance, collaboration, and decision making. It helps information and knowledge flow to and between the right people at the right time so they can act more efficiently and effectively to create value.

Figure 7: “Timely Actions Taken” Attribute Scores in FY 2021 (out of 100 percent)

Quarter	Standard Form 1023-EZ ¹⁵	Pre-Determination Form 1023-EZ ¹⁶	Form 1023-EZ Referrals ¹⁷	All Other Determinations ¹⁸
First	3%	8%	0%	47%
Second	1%	14%	2%	11%
Third	0%	7%	0%	11%
Fourth	1%	0%	0%	7%
Annual ¹⁹	1%	11%	1%	14%

Source: *Quality Report, FY 2021, Quarter 4.*

Not correcting known deficiencies may lead to unnecessary processing inefficiencies and taxpayer burden.

Recommendation 5: The Director, Exempt Organizations, should ensure that actions taken to address common quality deficiencies identified during the quarterly mandatory reviews and QMP case analyses effectively resolve the issues and take additional actions, if necessary, to improve the quality of case processing.

Management’s Response: The IRS agreed with this recommendation and will ensure that actions taken to address common quality deficiencies identified during the quarterly mandatory reviews and QMP analyses effectively resolve the issues and take additional actions, if necessary.

Exempt Organizations Determinations Management Has Not Established Quantifiable Goals for Quality Review Results

Although the EODQA Unit completes a statistically valid review of determination cases to verify quality, EOD management does not have quantifiable goals to measure the level of success for the quality of determinations processing. Without goals, quality review results do not provide a means to measure improvements in the determinations program.

¹⁵ A standard review entails tax examiners reviewing the information provided on the application and information that is already part of the IRS records.

¹⁶ A pre-determination review is a more in-depth review of the application, similar to what a Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, application’s review entails.

¹⁷ If tax examiners cannot make a determination during their standard review, they make a referral for a revenue agent to process the application. Revenue agents perform additional research and request additional information from the organization to make a determination.

¹⁸ Other forms, such as Form 1023, Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, and Form 1024-A, *Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code*, are used to request tax-exempt status.

¹⁹ The annual scores for each attribute are not computed by averaging the quarterly results. Instead, the results from the entire year are used to compute the annual scores.

Procedural Changes and Training Could Improve the Processing of Proposed Denied Applications for Tax Exemption

The IRS has a Balanced Performance Measurement System which includes measuring the quality of business results. As part of this system, the IRS is supposed to establish a baseline for first-year measures and future goals are based on prior year performance and current budgetary considerations. The Balanced Performance Measurement System enables the IRS to use performance results to, among other things:

- Measure how an organizational unit performs relative to its past performance.
- Align and support various review processes.
- Identify the factors that influence performance.

Quality review goals are essential to performance measures because they:

- Provide direction to program management and employees about where and how the IRS desires to improve in an area.
- Allow meaningful evaluation of progress because it is immediately clear whether the goals have been met or little progress has been made.
- Facilitate accountability for the level of results achieved.

EOD management stated that the goal for each attribute reviewed is to have as few errors as possible identified during the EODQA unit's quality reviews. However, without measurable goals, it is difficult for management to determine if corrective actions taken improved performance or additional actions are needed to attain quality goals. Goals help measure how an organization performs relative to its past performance and shows the progress in management's efforts to improve the quality of programs.

Recommendation 6: The Director, Exempt Organizations, should develop baseline goals for EODQA quality review scores and adjust them periodically, as needed.

Management's Response: The IRS agreed with this recommendation and will develop baseline goals for EODQA quality review scores and adjust them periodically, as needed.

Training for Exempt Organizations Determinations Specialists and Quality Assurance Reviewers Included Discussions of Civil and Constitutional Rights

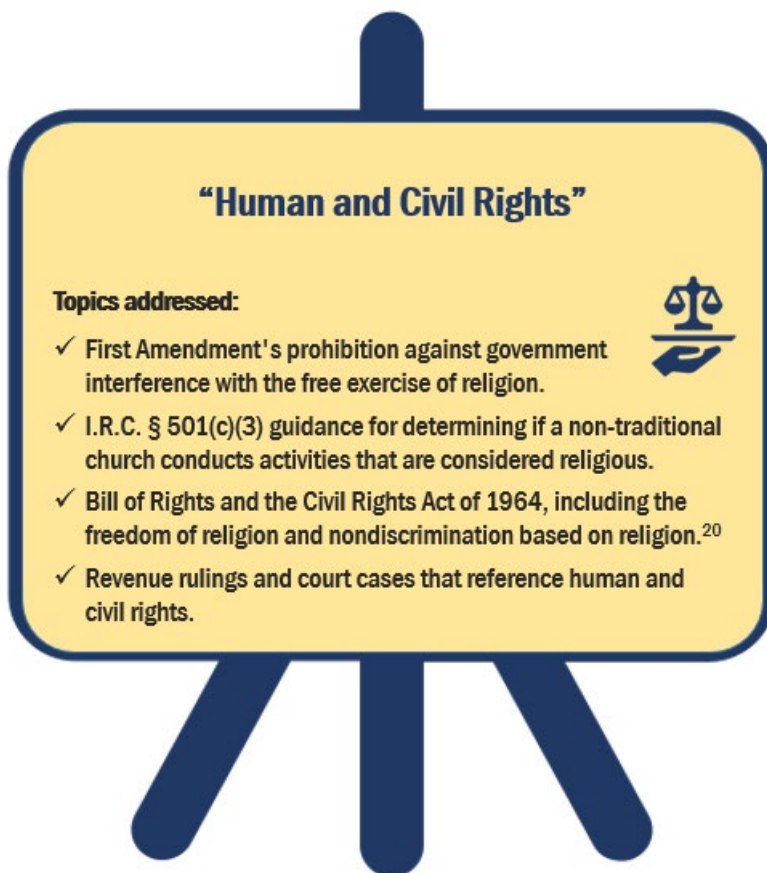
The memorandum from members of the U.S. Senate included a request for TIGTA to determine if civil and Constitutional rights are part of the training received by EOD specialists and Quality Assurance reviewers. We determined that civil rights related to protection from discrimination based on religion and the First Amendment related to freedom of religion are relevant to our review of the determinations process.

A lesson called *Religious Organizations and Churches* is included in the new hire determinations training that generally all EOD specialists, Quality Assurance reviewers, and their managers attend. This lesson includes the criteria used and factors considered when determining whether an organization is a church. The course also provides guidance for determining whether a non-traditional church conducts activities that are considered religious within the meaning of I.R.C. § 501(c)(3), regardless of the church's beliefs. It also emphasizes that although every church may be a religious organization, not every religious organization is a church. Training

participants are provided with information about how a religious organization may be distinguished from a church.

In addition, during an August 2020 Continuing Professional Education training for EOD specialists, Quality Assurance reviewers, and their managers, one session, titled *Human and Civil Rights*, covered the different types of organizations applying for exemption that defend human and civil rights, including the qualifications for exemption. Figure 8 shows the topics discussed during this session.

Figure 8: Training Topics on “Human and Civil Rights”



Source: August 2020 Continuing Professional Education training material.

²⁰ Pub. L. No. 88-352, 78 Stat. 241 (codified as amended in scattered sections of 2, 28, and 42 U.S.C.).

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to evaluate the Tax Exempt and Government Entities Division's oversight controls and procedures when issuing proposed adverse I.R.C. § 501(c)(3) tax-exempt status determination letters. To accomplish our objective, we:

- Identified the criteria, processes, and controls for processing, reviewing, and issuing proposed adverse determination letters performed by the EOD and EODQA units and interviewed staff, as necessary.
- Assessed how the IRS evaluates its own review process, including information on the IRS's corrective action procedures, if deficiencies are identified.
- Obtained application data for I.R.C. § 501(c)(3) tax-exempt status applications closed during FY 2021 from the Employee Plans/Exempt Organizations Determination System and completed a data reliability assessment.
- Reviewed case file information and documents, including the facts and circumstances surrounding all 68 proposed adverse determinations closed in FY 2021 to determine if established procedures and controls were followed appropriately.
- Evaluated the training provided to IRS personnel who participate in tax-exempt status determination decisions or prepare related determination correspondence and determined whether a particular emphasis is placed on information related to religious organizations or affiliations.

Performance of This Review

This review was performed with information received from the Exempt Organizations Rulings and Agreements office in Cincinnati, Ohio, during the period December 2021 through September 2022. 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.

Major contributors to the report were Bryce Kisler, Assistant Inspector General for Audit (Management Services and Exempt Organizations); Carl Aley, Director; Cheryl Medina, Audit Manager; Jenn Burgess, Lead Auditor; Beth Golden, Senior Auditor; and Michael McGovern, Auditor.

Validity and Reliability of Data From Computer-Based Systems

We performed tests to assess the reliability of data from the Employee Plans/Exempt Organizations Determination System. We evaluated the data by 1) performing electronic testing of required data elements and 2) interviewing agency officials knowledgeable about the data. We determined that the data were reliable for the purposes of this report.

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: EOD and EODQA units' policies, procedures, and practices for processing proposed adverse determinations of I.R.C. § 501(c)(3) tax-exempt status. To assess these controls, we reviewed 68 closed proposed denial cases to determine if the procedures provided consistent taxpayer treatment, protected taxpayer's rights, and limited taxpayer burden. We also interviewed staff from the EOD and EODQA units to obtain an understanding of the policies and procedures for processing applications for tax-exempt status.

Appendix II

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

November 28, 2022

MEMORANDUM FOR HEATHER M. HILL
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Eric D. Slack, Acting for Edward T. Killen Eric D. Slack
Commissioner,
Tax-Exempt and Government Entities Division (TE/GE)

Digitally signed by Eric D.
Slack
Date: 2022.11.28 13:53:35
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SUBJECT: Draft Report – Procedural Changes and Training Could Improve
the Processing of Proposed Denied Applications for Tax
Exemption (Audit # 202210029)

Thank you for the opportunity to review your draft report titled: "Procedural Changes and Training Could Improve the Processing of Proposed Denied Applications for Tax Exemption." Each year we process tens of thousands of applications for exempt status, and we appreciate your recommendations intended to ensure continued effective review and processing of proposed denials of tax-exempt status as part of that process.

In fiscal year 2021, we closed approximately 90,000 applications for Section 501(c)(3) status, approving about 78,000 of those and denying about 60, while about 12,000 were closed in other ways, such as withdrawal by an applicant before a determination. We make determinations of tax-exempt status based solely on the facts, attestations, and representations in the administrative file of each individual case. We are committed to respecting taxpayer rights in this process, including the rights to be informed, to challenge the IRS's position and be heard, and to appeal an IRS decision in an independent forum. We appreciate your acknowledgment that training for our employees included discussion of civil and Constitutional rights. As described in the report, we maintain standard procedures to process adverse determinations of tax-exempt status, which include having specialists discuss the potential denial with an applicant and mandatory review by Quality Assurance (QA) reviewers before issuance. Our procedures also provide applicants an opportunity to appeal a proposed denial to the IRS Independent Office of Appeals. Applicants that receive a denial ultimately can seek a declaratory judgment from a court regarding tax-exempt status.

The QA program includes two main types of review: mandatory review and sample review, which is our Quality Measurement Process or QMP. Mandatory review evaluates identified open cases, including proposed adverse determinations, for technical and procedural accuracy. This process ensures the quality of individual cases, which is beneficial to taxpayers and the IRS. To this end, we plan to implement your

**Procedural Changes and Training Could Improve the Processing of
Proposed Denied Applications for Tax Exemption**

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recommendations that relate to updating procedures and providing refresher training to ensure we follow our existing procedures and fully document case files as part of issuing adverse determinations

QMP involves reviewing a statistical sample of closed determinations and is a valuable tool that we use to assess overall technical accuracy, adherence to procedures, uniform treatment of taxpayers, and to identify trends or areas for improvement. The QMP results are shared with leadership, management, and employees, and we use the data from the QMP to make decisions on training and employee development needs and to identify process improvement opportunities. For instance, we have shifted resources to case processing that have addressed and improved timeliness scores impacted by the COVID-19 pandemic. Nevertheless, we strive for continuous improvement in this area and appreciate your recommendation to ensure actions taken to address common issues effectively resolve those issues and to develop baseline goals for QMP scores.

We appreciate the opportunity to review and comment on the draft report. Attached is a detailed response to your recommendations. If you have any questions, you or your staff may contact me or Robert W. Malone, Director, Exempt Organizations and Government Entities at Robert.Malone@irs.gov.

Attachment

**Procedural Changes and Training Could Improve the Processing of
Proposed Denied Applications for Tax Exemption**

Attachment

**Corrective Actions for TIGTA Audit Draft Report –
Procedural Changes and Training Could Improve the Processing of Proposed Denied
Applications for Tax Exemption (Audit #202210029)**

RECOMMENDATION 1:

The Director, EO, should ensure that EOD specialists complete Form 14280, update it to reflect current procedures, and require EOD managers to review and sign off on the form to help ensure that specialists complete all required actions.

CORRECTIVE ACTION:

The IRS will update Form 14280 to reflect current procedures and require managers to sign off on Form 14280 to ensure it is completed by specialists.

IMPLEMENTATION DATE:

April 15, 2023

RESPONSIBLE OFFICIAL(S):

Director, Exempt Organizations, Rulings and Agreements, TE/GE

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 2:

The Director, EO, should revise procedures to require that EOD specialists discuss and document required topics with the applicants prior to developing proposed denial letters, and require Quality Assurance reviewers to ensure that specialists have discussed each topic.

CORRECTIVE ACTION:

The IRS has procedures in place that require specialists to call organizations before preparing a proposed adverse determination letter to discuss specified topics. IRS will update procedures to require specialists document discussion of the required topics and that QA reviewers confirm the documentation as part of review procedures.

IMPLEMENTATION DATE:

February 15, 2023

RESPONSIBLE OFFICIAL(S):

Director, Exempt Organizations, Rulings and Agreements, TE/GE

**Procedural Changes and Training Could Improve the Processing of
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CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 3:

The Director, EO, should update procedures to require that Quality Assurance reviewers document in their case activity logs contacts with EOD specialists to determine if protests were received prior to issuing final adverse determination letters.

CORRECTIVE ACTION:

The IRS will update procedures to require Quality Assurance reviewers document case activity logs for contacts with specialists to determine if protests were received prior to issuing final adverse determination letters.

IMPLEMENTATION DATE:

March 15, 2023

RESPONSIBLE OFFICIAL(S):

Director, Exempt Organizations, Rulings and Agreements, TE/GE

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 4:

The Director, EO, should provide refresher training on the documentation requirements for proposed adverse determination case files to EOD specialists and Quality Assurance reviewers.

CORRECTIVE ACTION:

The IRS will provide refresher training on the documentation requirements for proposed adverse determination case file to EOD specialists and Quality Assurance reviewers.

IMPLEMENTATION DATE:

July 15, 2023

RESPONSIBLE OFFICIAL(S):

Director, Exempt Organizations, Rulings and Agreements, TE/GE

CORRECTIVE ACTION MONITORING PLAN:

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

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RECOMMENDATION 5:

The Director, EO, should ensure that actions taken to address common quality deficiencies identified during the quarterly mandatory reviews and QMP case analyses effectively resolve the issues and take additional actions, if necessary, to improve the quality of case processing.

CORRECTIVE ACTION:

The IRS will ensure actions taken to address common quality deficiencies identified during the quarterly mandatory reviews and QMP analyses effectively resolve the issues and take additional actions, if necessary.

IMPLEMENTATION DATE:

May 15, 2023

RESPONSIBLE OFFICIAL(S):

Director, Exempt Organizations, Rulings and Agreements, TE/GE

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 6:

The Director, EO, should develop baseline goals for EODQA quality review scores and adjust them periodically, as needed.

CORRECTIVE ACTION:

The IRS will develop baseline goals for EODQA quality review scores and adjust them periodically, as needed.

IMPLEMENTATION DATE:

May 15, 2023

RESPONSIBLE OFFICIAL(S):

Director, Exempt Organizations, Rulings and Agreements, TE/GE

CORRECTIVE ACTION MONITORING PLAN:

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

Appendix III

Abbreviations

EOD	Exempt Organizations Determinations
EODQA	Exempt Organizations Determinations Quality Assurance
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
QMP	Quality Measurement Process
TIGTA	Treasury Inspector General for Tax Administration



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By Web:

www.treasury.gov/tigta/

Or Write:

Treasury Inspector General for Tax Administration

P.O. Box 589

Ben Franklin Station

Washington, D.C. 20044-0589

Information you provide is confidential, and you may remain anonymous.