Good morning Chairman Boustany, Ranking Member Lewis, and Members of the Oversight Subcommittee. Thank you for the opportunity to appear this morning. My name is Steven T. Miller, and I am the Deputy Commissioner for Services & Enforcement for the Internal Revenue Service (IRS).

Exempt Organizations is an office within Tax Exempt and Government Entities (TE/GE), one of four operating divisions created after the enactment of the IRS Restructuring and Reorganization Act of 1998 (RRA). Its responsibilities include charities and other tax-exempt organizations.

At the request of the Subcommittee, my testimony this morning will offer an overview of one segment of the tax-exempt community, specifically section 501(c)(3) organizations and our role in regulating that community. I will highlight the general law that applies to these organizations and the key administrative processes we employ in our work with this sector.

Let me begin with two observations. First, the charitable sector deserves to be commended for the vital work it does throughout America, and indeed throughout the world. Second, on the whole, we believe the charitable sector is, or tries to be, compliant with the Internal Revenue Code.

Demographics of the Tax-Exempt Community

Internal Revenue Code section 501(c)(3) describes a subset of the entire tax-exempt sector. Section 501(c)(3) organizations include those organized and operated exclusively for religious, charitable, scientific, educational, and other specified exempt purposes. They are eligible to receive tax-deductible contributions, and they are subject to certain operating restrictions.

Currently, there are more than one million section 501(c)(3) organizations. This includes public charities and private foundations. In tax year 2009, section 501(c)(3) public charities held assets valued at approximately $2.7 trillion, and had annual revenues of nearly $1.5 trillion. Private foundations held assets valued over $500 billion, and had annual revenues of $52 billion. These numbers do not include churches because they generally have no registration or filing requirements.
General Law Governing Section 501(c)(3) Organizations

The Internal Revenue Code specifies certain types of organizations that are exempt from federal income tax.¹ The most common are charitable, religious and educational organizations, civic associations, labor organizations, business leagues, social clubs, fraternal organizations, and veterans’ organizations.²

Not all non-profit organizations are tax-exempt under federal law.³ To be tax-exempt, the organization generally must meet specific requirements of the Code, such as being described in a paragraph of section 501(c) of the Code.⁴

With limited exceptions, section 501(c)(3) organizations must apply to be recognized as tax-exempt.⁵ They do this by filing a Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, with the IRS.⁶ Churches and certain church-related organizations, very small organizations, and certain other organizations do not need to apply for tax-exempt status under section 501(c)(3).⁷

We consistently receive about 60,000 applications for tax-exempt status each year. Most are requesting status under section 501(c)(3).

If the IRS approves an application, we issue a “ruling letter” or a “determination letter.”⁸

Contributions to section 501(c)(3) organizations are generally deductible on the donor’s federal income tax return, if the donor chooses to itemize deductions.⁹ Contributions to most other types of tax-exempt organizations do not qualify for a charitable contribution deduction.¹⁰

Section 501(c)(3) organizations are the largest category of exempt organizations. These organizations are organized and operated exclusively for religious, charitable, scientific, educational, or other specified purposes and no part of their net earnings may inure to the benefit of any private shareholder or individual, no substantial part of their activities may be carrying on propaganda, or otherwise attempting to influence legislation (except in certain circumstances), and which do not participate in, or intervene in, any political campaign on behalf of (or in

¹ IRC § 501(a); Treas. Reg. § 1.501(a).
² IRC § 501(c); Treas. Reg. §§ 1.501(c)(3)-1 through 1.501(c)(21)-1.
³ Treas. Reg. § 1.501(a)-1(a)(2).
⁴ Treas. Reg. § 1.501(a)-1(a)(1).
⁵ Treas. Reg. §§ 1.501(a)-1(a)(3); 1.508-1.
⁶ Id.
⁷ IRC § 508(c)(1); Treas. Reg. § 1.508-1(a)(3).
⁸ Treas. Reg. § 1.501(a)-1(a) (2); Treas. Reg. § 301.6104(a)(1).
⁹ IRC § 170; Treas. Reg. § 1.170-2.
¹⁰ But see IRC § 170(c)(3), (4), (5).
opposition to) any candidate for public office. The regulations divide this statutory language into two requirements. To qualify for exemption under section 501(c)(3), the organization must be:

- **Organized**, and
- **Operated** exclusively for one or more exempt purposes.

The organizational requirement is that a section 501(c)(3)’s organizing documents (articles of incorporation, trust documents, articles of association, etc.) must:

- Limit its purpose or purposes to those described in section 501(c)(3),
- Not expressly empower the organization to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, and
- Dedicate its assets to exempt purposes, for example by ensuring that upon dissolution its assets will be distributed to another charitable organization or government entity.

The operational requirement is that a section 501(c)(3) organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is in furtherance of a non-exempt purpose.

In addition, a section 501(c)(3) organization cannot:

- Participate in political campaigns on behalf of, or in opposition to, any candidate for public office,
- Perform lobbying activities as a substantial part of its overall activities,
- Allow its earnings to inure to the benefit of any private shareholder or individual,
- Operate for the benefit of private interests, such as those of its founder, the founder’s family, its shareholders, or persons controlled by such interests, or
- Operate for the primary purpose of conducting a trade or business that is not related to its exempt purpose.

---

11 IRC § 501(c)(3)
12 Treas. Reg. § 1.501(c)(3)-1(a).
14 Id.
16 Treas. Reg. § 1.501(c)(3)-1(c)(1).
17 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(3) (ii); § 1.501(c)(3)-1(c)(3).
18 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(3) (i); § 1.501(c)(3)-1(c)(3).
19 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(c)(2).
20 Treas. Reg. § 1.501(c)(3)-1(d) (1) (ii).
21 Treas. Reg. § 1.501(c)(3)-1(e).
The most common types of section 501(c)(3) organizations are charitable, educational, or religious.

The term “charitable” is used in section 501(c)(3) in its generally accepted legal sense. While the regulations and other sources list charitable purposes, other purposes may also fall within the broad definition of “charitable” as developed by judicial decisions. “Charitable purposes” may include the following purposes identified in the regulations:

- Relief of the poor, the distressed, or the underprivileged,
- Advancement of religion,
- Advancement of education or science,
- Building or maintaining public buildings, monuments, or works,
- Lessening the burdens of government,
- Reducing neighborhood tensions,
- Helping eliminate prejudice and discrimination,
- Defending human and civil rights, and
- Combating community deterioration and juvenile delinquency.

An educational organization is one involved in:

- The instruction or training of the individual for the purpose of improving or developing his capabilities, or
- The instruction of the public on subjects useful to the individual and beneficial to the community.

Religious organizations include churches and other organizations organized and operated exclusively for religious purposes.

Public Charity or Private Foundation
Every organization that qualifies as tax-exempt under section 501(c)(3) is classified as either a public charity or a private foundation. Under Section 508, organizations (other than churches, certain educational organizations, and certain trusts) are automatically classified as private foundations, unless they can meet the criteria for being a public charity listed in Section 509(a). Whether a section 501(c)(3) organization is classified as a public charity or private foundation is important because different tax rules apply to each. For example, the deductibility of contributions to a private foundation is more limited than the deductibility of contributions to a public charity. In addition, private foundations

---

22 Treas. Reg. § 1.501(c)(3)-1(d)(2).
23 Id.
24 Treas. Reg. § 1.501(c)(3)-1(d)(3) (i).
25 Treas. Reg. §§ 1.508-1(b); 1.509(a)-1; 1.509(a)-2.
are subject to stricter federal regulation and may be subject to excise taxes not imposed on public charities.27

One common distinction between public charities and private foundations lies in their sources of financial support.28 A public charity typically has a broad base of public support, whereas a private foundation generally is supported by just a few individuals, such as members of a family.29

To be classified as a public charity, either because it performs specific types of activities identified in the Code (e.g. churches, schools, hospitals, etc.) or because of its public support, an organization must meet one of the tests set out in the Code and accompanying regulations.30

Common organizations meeting the definition of public charity under Section 509(a) include:
  • Churches,
  • Schools,
  • Organizations that provide medical or hospital care,
  • Organizations that receive a substantial part of their support in the form of contributions from publicly supported organizations, governmental units and/or from the general public, and
  • Organizations that normally receive not more that one-third of their support from gross investment income and after-tax unrelated business income, and more than one-third of their support from gifts, grants, contributions, or membership fees and gross receipts from activities related to their exempt functions.

Role of the IRS
Congress has established in the tax law certain requirements that organizations must meet to be entitled to the privilege of tax exemption. It is the IRS's responsibility to administer those requirements.

The IRS has a balanced program for regulating the charitable sector. Within the IRS, the Tax Exempt and Government Entities division (TE/GE) has the responsibility to administer and enforce these requirements. Doing so accomplishes a number of important public purposes. It ensures that Congressional intent is honored. It helps maintain public confidence in the integrity of the charitable sector. And it prevents the erosion of the tax base by identifying and stopping those who misuse the privilege of tax-exempt status.

The IRS approaches this responsibility with a program that emphasizes both service and enforcement. The program is carried out by the 868 employees of

---

27 Chapter 42 of the Code [i.e., IRC §§ 4940-4946].
28 IRC § 509(a)(2); Treas. Reg. § 1.509(a)-3.
29 Treas. Reg. §§ 1.509(a)-1; 1.509(a)-3.
30 IRC §§ 170(b)(1)(A)(vi) and 509(a)(2); Treas. Reg. §§ 1.170A-9; 1.509(a)-2; and 1.509(a)-3.
TE/GE’s Exempt Organization function (EO). EO’s efforts in this area fall into four categories: determinations or rulings on applications for tax exemption, public education and outreach, guidance, and post-filing compliance.

**Application for Tax-Exemption**

TE/GE’s application program for organizations seeking exempt status is particularly important. In this program, prospective exempt organizations submit information to the IRS about their purpose and structure. Determination specialists review the applications and, where appropriate, work individually with the applicant organization to help them understand the requirements for tax exemption and any necessary changes. Unless the organization is later selected for examination, the determination process is often the only time the IRS is in direct contact with the organization.

The application process therefore represents an important opportunity for the IRS. It is the time when the IRS has the chance to ensure that the charity is organized as required by law, that the organization is operating properly, and that the IRS has the information it needs about the organization. The determination letter process also presents an important educational opportunity for the applicant to learn of its responsibilities and filing obligations as a tax-exempt organization.

Most organizations seeking recognition of exemption from federal income tax must use specific application forms prescribed by the IRS. Primarily, these are Form 1023, *Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code*, and Form 1024, *Application for Recognition under Section 501(a)*.

**Customer Education & Outreach**

TE/GE conducts an active education and outreach program for the charitable sector. This effort is designed to keep exempt organizations compliant by keeping them alert to the requirements of the law and by giving them the opportunity to have their questions answered.

We also accomplish this through a balanced program that provides both “online” educational materials that are available 24/7, as well as “real time” events such as workshops, seminars, on-line webinars, speeches, and phone forums.

Our “online” effort involves extensive use of electronic media. A free e-mail newsletter, *EO Update*, reaches over 188,000 subscribers (up 23 percent from FY2010). Our numerous publications and other materials are increasingly distributed online. And the EO website (www.irs.gov/charities) plays an important and growing role as a resource for tax-exempt organizations. EO’s homepage had 2 million visits in the first five months of calendar 2012 – a monthly average of 335,000 visits.
The web site includes web-based information tools called “Life Cycles.” Each Life Cycle provides practical information about each of five stages organizations typically go through during their existence: starting the organization; applying for tax-exempt status; filing required returns and other documents; maintaining the organization; and terminating the organization. We provide Life Cycles not only for public charities and private foundations, but also for other tax-exempt organizations such as social welfare organizations, labor organizations, agricultural and horticultural organizations such as farm bureaus, and trade associations and other business leagues. Another popular tool we offer is StayExempt.org, a web-based version of our day-long workshop for small and mid-size exempt organizations.

The exempt organizations community is using these tools. In the year ended June 30, 2012, for example, we recorded more than 119,000 visits to the public charity life cycle site; over 50,000 visits to the private foundation life cycle site; and over 142,000 visits to StayExempt.org.

We provide education and outreach to exempt organizations through “real time” events such as workshops, seminars, online webinars, speeches, and phone forums. In FY 2011, we reached 41,252 customers through our real time events – a 28 percent increase over FY 2010. We conducted 30 day-long workshops, held at different colleges and universities, for small and medium size section 501(c)(3) organizations.

In addition to providing general education about the responsibilities of tax-exempt organizations, advising charities about changes in the tax law helps them stay compliant. For example, the Pension Protection Act of 2006 requires automatic revocation of exempt status of organizations that fail to file a Form 990-series return for three consecutive years. We conducted extensive outreach on this issue, and launched SelectCheck, a searchable online database to help the tax-exempt community and the public track organizations’ tax-exempt status.

Post-Filing Compliance

While we provide an upfront evaluation of a charity’s exempt status and support exempt organizations with customer education and outreach, we also must have a process to review these organizations as they operate. We therefore maintain a robust and multi-faceted post-filing compliance program. We are organized and staffed in a way that allows us to respond flexibly to different types of non-compliance in different areas. We constantly seek more efficient and effective ways to conduct examinations, and continuously refine our selection criteria to help us apply compliance resources where they are most needed.

IRS Exempt Organizations agents conduct reviews of exempt organizations in various ways:
“Review of Operations Office” reviews: The Review of Operations Office (ROO) carries out its post-filing compliance work without needing to contact taxpayers. A ROO review is not an examination; the ROO looks at an organization’s Form 990, website, and other publicly available information to see what it is doing and whether it continues to be organized and operated for tax-exempt purposes. The ROO looks at a random sample of new organizations after they have operated for a year or two, and also follows up with older organizations that we have examined and with whom we have entered into a closing agreement to resolve compliance issues. If it appears from a ROO review that an organization may not be compliant, the organization is referred for examination. Separately, the ROO conducts the statutorily mandated community benefit reviews of tax-exempt hospitals.

Compliance checks: In a compliance check, we contact taxpayers by letter when we discover an error on a taxpayer’s return or wish to obtain further information or clarification. A compliance check is an efficient and effective way to maintain a compliance presence without an examination. We also use compliance check questionnaires to study a specific part of the tax-exempt community or specific cross-sector practices.

Examinations: Examinations, also known as audits, are authorized under Section 7602 of the Code. For exempt organizations, an examination determines an organization’s continued qualification for tax-exempt status. We conduct two different types of examinations: correspondence and field.

- **Correspondence examination:** In a correspondence examination, the examiner conducts the audit through correspondence with the organization’s officers or representatives. These audits are often limited in scope, focusing on only one or two items on a return. On occasion, if the issues become complex or if the organization does not respond to correspondence efforts, the IRS may require representatives from the organization to bring their records to an IRS office. We may also convert a correspondence examination into a field examination.

- **Field examination:** In a field examination, the examiner conducts the audit at the organization’s place of business. Generally, these exams are the most comprehensive. There are two distinct types of Exempt Organizations field examinations:

  1. Under the Exempt Organizations Team Examination Program, examinations are conducted by a team of IRS specialists. The IRS typically uses team examinations for the largest exempt organizations.
2. Under the Exempt Organizations General Program, an examination is usually performed by an individual revenue agent.

The post-filing compliance program is aimed at detecting and deterring noncompliant behavior. We have strengthened this program by broadening our approach and shifting resources into it. In FY 2003, we had 394 examinations full time equivalents (FTE) and closed 5,754 returns. In FY 2011, we had 531 examinations FTE, and through a combination of enforcement projects and traditional examinations, closed 11,699 returns, more than doubling the 2003 figure. We also completed 3,194 compliance checks. We are strengthening the program by using results from completed examinations, new data from the redesigned 990, our studies of customer segments, and the application of research techniques to distinguish between those who are willfully noncompliant and those who make errors while attempting to follow the rules. We then apply our examination resources accordingly.

Reporting Requirements

Most exempt organizations must file one of the Form 990-series returns – the 990, 990-EZ, 990-N, or the 990-PF. There are certain exceptions, such as for churches and their related organizations.

Form 990. For tax year 2010 and beyond, an organization that is not a private foundation must file Form 990 if it does not meet the criteria for filing the Form 990-EZ or Form 990-N.

Form 990-EZ. An organization that is not a private foundation with annual gross receipts of less than $200,000, and total assets less than $500,000 for the tax year may file Form 990-EZ instead of Form 990. Form 990-EZ is a shorter and simpler version of Form 990.

Form 990-N. Organizations that are not private foundations with annual gross receipts that are normally $50,000 or less may file Form 990-N instead of filing Form 990 or Form 990-EZ. The Form 990-N, also referred to as the “e-Postcard,” is filed electronically. Filing is very simple and requires no specialized computer equipment or software. The Form 990-N asks for:

- The employer identification number (EIN),
- Tax year,
- Legal name and mailing address,
- Any other names the organization uses,
- Name and address of a principal officer,

31 IRC § 6033.
32 IRC § 6033(a)(3).
• Website address, if the organization has one,
• Confirmation that the organization’s annual gross receipts are normally at or below the threshold, and
• If applicable, a statement that the organization is going out of business.

**Form 990-PF.** Private foundations must file the Form 990-PF.

Organizations with $10 million or more in total assets that file at least 250 returns during the calendar year (including income, excise, employment tax, and information returns) are required to file Form 990 electronically.

Organizations that are required to file a Form 990-series must file Form 990, 990-EZ, or the 990-N by the 15th day of the fifth month after their tax year ends. For example, May 15 would be the due date for an organization with a December 31 year-end. Organizations exempt under section 501(c) with gross income of $1,000 or more from a regularly conducted unrelated trade or business also file the Form 990 –T, Exempt Organization Business Income Tax Return.

The Form 990-series returns are unique and useful for four key reasons. First, the Form 990, Form 990-EZ and Form 990-N are information returns, not tax returns. The primary reason tax-exempt organizations file a return is to provide information on their programs and activities. We use this information to verify the organization is operating in accordance with its stated tax-exempt purpose and is not violating rules and regulations governing tax-exempt status.

Second, tax-exempt organizations are required to make their returns widely available for public inspection. Organizations must allow the public to inspect the Forms 990, 990-EZ, 990-N, and 990-PF they have filed with the IRS for their three most recent tax years. Exempt organizations are also required to provide copies of these returns when requested, or make them available on the Internet. They are also available from the IRS.

Third, exempt organization returns are used as multi-jurisdictional forms; nearly 40 states require exempt organizations to file some or all parts of a Form 990-series return to satisfy the states’ filing requirements.

Finally, these information returns promote transparency and accountability, which strengthens the relationship that an exempt organization has with its stakeholders and funders.

**Form 990 Redesign**

The Form 990, Return of Organization Exempt from Income Tax, is a key element of our compliance program. The IRS undertook a comprehensive redesign of Form 990 that was effective beginning with tax year 2008.
We began redesigning the Form 990 in 2004. The basic format and content of the form had remained essentially the same since 1979, while the community of tax-exempt organizations had grown dramatically in size, variety, and complexity. The prior Form 990, with its emphasis primarily on revenues and expenses, assets and liabilities, had grown outdated. It was primarily a series of yes/no checkboxes and numbers, but did not provide an accurate portrait of what an exempt organization was actually doing. Nor did it reflect the full scope, activities, or dynamics of modern, sometimes multi-leveled tax-exempt organizations. The form needed to be updated to meet the needs of the IRS and the public to understand the activities of tax-exempt organizations, and to confirm that these organizations were continuing to operate consistently with their tax-exempt purposes.

In redesigning the Form, the IRS followed three guiding principles:

- Promote compliance with the tax law,
- Promote transparency, and
- Minimize burden (where consistent with the first two principles).

The redesign was a comprehensive, collaborative effort in which the IRS sought and received extensive input from the public. We met with nonprofit associations, state charity regulators, public interest groups, policymakers, and various representatives of the tax-exempt community. We redesigned the Form 990 based on input from both our own internal stakeholders (e.g., our Examinations and Submission Processing functions) and these external groups.

Once we developed a draft redesigned form, we released it to the public, including the exempt sector, and asked for comment. To help all filers become familiar with the Form, we released two drafts of the 2008 Form 990, and a draft of the instructions, in the year and a half before we published the final Form. We accompanied these drafts with educational resources showing how the Form had changed, and including tips for completing it. Over the course of a year and a half, we held seminars and provided speakers for interested parties. We explained the new format (a core form and schedules), what we were asking for and why, and we solicited comments. We wanted to know from affected organizations and practitioners whether the draft form’s questions were relevant, reasonable, and feasible to answer.

We met with stakeholders, who had provided comments to make sure we understood them, and we had conversations about what we – and they – were trying to accomplish. Where recommended revisions furthered our goals of transparency, compliance, and/or minimizing taxpayer burden, we revised the form. We considered every comment that was submitted, and made many further changes based on them. The final Form 990 took effect in the 2008 tax year.

The redesign is evolving, and we continue to receive comments from the sector and to refine the form.
We recognized that the transition from the old to the new Form 990 would change the way some organizations capture and track data needed to complete the form. To give small and mid-sized organizations with fewer legal, accounting, and administrative resources more time to adapt to the redesigned form, we provided transition relief. We implemented a three-year phase-in period, raising the asset and gross receipts thresholds for Form 990 filing by ten-fold for tax year 2008 (from $100,000 in gross receipts and $250,000 in assets to $1 million and $2.5 million, respectively), by five-fold for tax year 2009 ($500,000 and $1.25 million), and ending at $200,000 and $500,000 for tax years 2010 and later. The transition allowed hundreds of thousands of smaller and mid-sized organizations that would have been required to file the Form 990 for tax years 2008 and 2009 to file the shorter Form 990-EZ for one or both of those years. This transition period also gave organizations time to progressively enable their internal systems to respond to the new requirements.

We have posted on our website, IRS.gov/eo, many audio, visual, and written tools to assist filers in understanding and completing the Form 990 and its schedules. We also speak at conferences, seminars, and webinars throughout the year to reach thousands of representatives of tax-exempt organizations and answer their questions about Form 990 preparation. We continue to accept comments through the IRS Form 990 comment mailbox.

In short, the redesign of the Form 990 remains an ongoing and continuing process that will continue as the IRS monitors levels of compliance, shareholder needs, and changes to the law.

**Conclusion**

I have provided you with descriptions of the general law applicable of section 501(c)(3) organizations, and of the key elements of our regulatory and education and outreach programs.

We look forward to continuing our work with this Subcommittee, with the Congress, and with all parts of the charitable sector and its leaders as it continues to evolve and change. We will work to insure that the public remains confident that its contributions of time, effort, and money, are used for charitable purposes.

Thank you again for the opportunity to be here this morning and for your interest in this subject. I will be happy to answer your questions.