



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

DEPUTY COMMISSIONER

June 15, 2012

The Honorable Charles Boustany  
U.S. House of Representatives  
Washington, DC 20515

Dear Mr. Boustany:

I am responding to the letter from you and your colleagues to Commissioner Shulman dated April 23, 2012, requesting information about the tax-exempt sector. In particular, your letter raises concerns regarding the requests by the IRS for additional information from applicants for tax exemption. To assist in responding to your concerns, we are also providing background information about our long-standing system for processing applications for tax-exempt status.

### **Application Process**

The law allows section 501(c)(4) organizations to hold themselves out as tax-exempt. Organizations also can apply for IRS recognition as tax-exempt. Whether an organization is self-declared under section 501(c)(4) or has been determined by the IRS to meet the requirements of section 501(c)(4), the organization must file Form 990 annual information returns.

All applications for tax-exempt status, including applications for status under section 501(c)(4), are filed with a centralized IRS Submission Processing Center. The application is then sent to the Exempt Organizations ("EO") Determinations office in Cincinnati, Ohio for initial technical screening.

This technical screening is conducted by experienced revenue agents who review the applications and, based on that review, separate the applications into the following four categories:

- Applications that can be approved immediately based on the completeness of the application and the information submitted;
- Applications that need only minor additional required information in the file in order to approve the application;
- Applications that do not contain the information needed to be considered substantially complete; and

- Applications that require further development by an agent in order to determine whether the application meets the requirements for tax-exempt status.

Organizations whose applications fall into the fourth category are sent letters informing them that more development of their application is needed, and that they will be contacted once their application has been assigned to a revenue agent. The applications are sent to unassigned inventory, where they are held until a revenue agent with the appropriate level of experience for the issues involved in the matter is available to further develop the case.

Once the case is assigned, the revenue agent notifies the organization and reviews the application. Based upon established precedent and the facts and circumstances set forth in the application, the revenue agent requests additional information and documentation to complete the file pertaining to the exempt status application materials<sup>1</sup> (the so-called “administrative record”) and makes a determination. Where an application for exemption presents issues that require further development to complete the application record, the revenue agent engages in a back and forth dialogue with the organization in order to obtain the needed information.

The general procedures for requesting additional information to develop an application are included in section 7.20.2 of the Internal Revenue Manual. Although there is a template letter that describes the general information on the case development process, the letter does not, and could not, specify the information to be requested from any particular organization because of the broad range of possible facts. The amount and nature of development necessary to process an application to ensure that the legal requirements of tax-exemption are satisfied depends on several factors, which include the comprehensiveness of the information provided in the application and the issues raised by the application. Consequently, revenue agents prepare individualized questions and requests for documents relevant to the application, which are attached to the above described general template letter.

This back and forth dialogue helps applicants better understand the requirements for exemption and what is needed to meet them, and allows the IRS to obtain all the information relevant to the determination. If an organization believes that the legal requirements can be satisfied without the requested documentation or the organization needs additional time to respond, the organization can discuss an alternative approach or timing with their agent. The IRS will consider whether compliance with the legal requirements can be satisfied in the alternative manner proposed and whether an extension of time is warranted. Once responses are received, the entire application file is evaluated based upon the requirements in the Code and regulations.

Tools are available to promote consistent handling of full development cases. For example, in situations where there are a number of cases involving similar issues (such as credit counseling organizations, down payment assistance organizations, organizations that

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<sup>1</sup> The application for recognition of tax exempt status, any papers submitted in support of the application, and any letter or other document issued by the IRS with respect to the application. See IRC § 6104(a), (d)(5).

were automatically revoked and are seeking retroactive reinstatement, and most recently, advocacy organizations), the IRS will assign cases to designated employees to promote consistency. Additionally, in these cases, EO Technical (an office of higher graded specialists in Exempt Organizations), in consultation with the IRS Office of Chief Counsel, may develop educational materials to assist the revenue agents in issue spotting and crafting questions to develop cases consistently.

It is important to develop a complete administrative record for the application. Because the administrative record must either support exemption or denial, it is important for the record to be complete. If the application is approved, not only is the administrative record made publicly available (with certain limited exceptions outlined below), but organizations that act as described in the administrative record have reliance on the IRS determination. If the application is denied, the organization may seek review from the IRS Office of Appeals. The Appeals Office, which is independent of Exempt Organizations, reviews the complete administrative record and makes its own independent determination of whether the organization meets the requirements for tax-exempt status. It is to the organization's benefit to have all of its materials in the file in the event EO Determinations denies exemption and the organization seeks Appeals review. If, based on the information in the administrative record, the Appeals Office decides the organization meets the requirements for tax-exempt status, the application will be approved. If the Appeals Office agrees that the application should be denied, the organization may challenge its non-exempt status by paying any tax owed as a taxable entity, and seeking a refund in federal court.

In those cases where the application raises issues for which there is no established published precedent or for which non-uniformity may exist, EO Determinations may refer the application to EO Technical. In EO Technical, the applications are reviewed by tax law specialists whose job is to interpret and provide guidance on the law and who work closely with IRS Chief Counsel attorneys on the issues.

Similar to the process in EO Determinations, EO Technical tax law specialists develop cases based on the facts and circumstances of the issues in the specific application. EO Technical staff engages in a back and forth dialogue with the organization in order to obtain the information needed to complete the administrative record. If, upon review of all of the information submitted, it appears that an organization does not meet the requirements for tax-exempt status, a proposed denial explaining the reasons the organization does not meet the requirements is issued. The organization is then entitled to a "conference of right" where it may provide additional information. Following the conference of right, a final determination is issued. If the application is approved, the administrative record is made publicly available, and if the organization acts as described in the application record, it has reliance on the IRS determination. If the application is denied, the applicant may challenge its non-exempt status by paying any tax owed as a taxable entity, and seeking a refund in federal court.

### **Processing Section 501(c)(4) Applications**

To qualify for exemption as a social welfare organization described in section 501(c)(4), the organization must be primarily engaged in the promotion of social welfare, not organized or

operated for profit, and the net earnings of which do not inure to the benefit of any private shareholder or individual.<sup>2</sup> The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.<sup>3</sup> A section 501(c)(4) social welfare organization can engage in political activities as long as it is primarily engaged in activities that promote social welfare.<sup>4</sup>

In working a determination application case, the revenue agent must determine whether activities undertaken by the organization primarily further an exempt purpose. If the organization is engaged in some activities that do not promote social welfare, then the agent must review the scope of the activities to determine whether, based on all the facts and circumstances, the organization's exempt activities are the primary activities. If the application is unclear or not sufficiently detailed as to whether the primary activity conducted by the organization is exempt social welfare activity, the revenue agent will need to follow-up on this issue in a development letter.

The activity that has recently attracted attention relates to processing of determination letter requests of organizations who sought recognition of tax-exempt status by the IRS. As previously discussed, the law does not require section 501(c)(4) organizations to apply to the IRS for recognition of tax-exempt status, but organizations may do so. Organizations seeking tax-exempt status under section 501(c)(3) are legally required to apply with the IRS.

As mentioned above, when EO notices an increase in similar cases or activities, steps are taken to coordinate processing of cases to promote consistent treatment of taxpayers. In late 2010, EO noticed an increase in determination application requests from organizations seeking tax exemption under section 501(c)(3) and section 501(c)(4) that appeared to be potentially engaged in political advocacy activities. Section 501(c)(3) organizations are legally prohibited from participating or intervening in a political campaign on behalf of or in opposition to any candidate for public office. Although such activity does not promote social welfare, section 501(c)(4) organizations are not prohibited from engaging in political campaign activity as long as the organization's primary activities promote social welfare. In working section 501(c)(4) determination application requests, the IRS must determine what are the primary activities of the organization and whether those activities promote social welfare.

Upon observing an increase in the number of section 501(c)(3) and section 501(c)(4) determination applications from organizations that appeared to be potentially engaged in political advocacy activities, EO took steps to coordinate the handling of the cases to ensure consistency. EO determination agents also began working with EO technical tax law experts to develop approaches and materials that could be helpful to the agents working the cases. As sometimes happens, however, coordination efforts resulted in some cases being in inventory for a longer time than expected.

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<sup>2</sup> IRC § 501(c)(4); Treas. Reg. § 1.501(c)(4)-1.

<sup>3</sup> Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

<sup>4</sup> Rev. Rul. 81-95, 1981-1 C.B. 332.

In early 2012, after development letters were sent to some applicant organizations, issues with respect to these cases were brought to the attention of EO management, who requested a status of the inventory and ensured more timely and consistent handling of the cases. We have made significant progress on these cases to date. Within the last month, a number of approvals have been granted. In many cases, updated information requests have been sent to focus on the specific legal issues in question. Per normal procedures for full development cases, EO staff is in the process of an active back and forth with organizations where there are questions as to whether the legal requirements for tax exemption have been satisfied. We are committed to working these cases in an expeditious manner. However, given the difficult fact intensive work that the law requires for complex cases, additional time may be needed in some instances to make a determination.

I hope this information is helpful. I am sending a similar response to your colleagues. If you have questions, please contact me or have your staff contact Catherine Barre at (202) 622-3720.

Sincerely,



Steven T. Miller