

Client Alert: Few Tax Exempt Organizations Examined By the IRS

22 Feb 2021

The Treasury Inspector General for Tax Administration (“TIGTA”) recently issued a report about its review of the Internal Revenue Service’s (“IRS”) examination of tax-exempt organizations.^[1] (“TIGTA Report”) The TIGTA Report analyzed examinations conducted by the IRS during fiscal year 2019. TIGTA found that there are many obstacles to overcome in order for IRS’ examiners to detect noncompliance by exempt organizations and churches.

In FY 2019, the number of organizations filing some type of Form 990^[2] was 1.5 million. The IRS examined approximately 2000 of those returns, or approximately 0.13%. An exempt organization’s chance of being audited was 1 in 742. That doesn’t even count churches, which are not required to file a Form 990. TIGTA reported a population of approximately 263,000 churches and other religious organization. These entities can be identified through filing of employment tax and other similar returns. Of the 263,000 identified churches and religious organizations, 39 religious entities were examined during FY 2019. That means a church has a 1 in 5,000 chance of being audited.

TIGTA noted that it is difficult to determine noncompliance based solely on the Form 990 and considered whether it would be useful to add more questions to Form 990. However, after review and discussions with IRS personnel, they decided not. Many of the examinations are started as a result of internal or external referrals: whistle-blowers. In fact, IRS’ employees are encouraged to submit suggestions for possible examinations of exempt organizations via a separate online portal.

The lack of church examinations is understandable given there is no requirement for the church to provide the IRS with information through any type of information return. Congress has also provided a cumbersome and tedious process that the IRS must go through prior to opening an examination of a church.^[3] Frankly, examining even 39 religious entities is impressive given the many layers of obstacles. Separation of church and state is real, as envisioned by the U.S. Constitution.

Although 2,000 organizations had examinations initiated in FY 2019, the IRS closed 3,675 examinations during that year. Of those closed, 900 of the returns were reviewed but for a variety of reasons were closed without examination or even contact with the taxpayer. The reasons varied from short-term time periods due to a statute of limitations about to expire, insubstantial issues or issues without merit. Not stated, but what must surely be an issue, is the lack of funding and the lack of staffing devoted to oversight of tax-exempt organizations.

Without effective oversight of exempt organizations, and even churches, there is little motivation for compliance by those who are instead motivated to flaunt the law for their own benefit. Another reason for the lack of compliance, as stated in the TIGTA Report: “The complexity of the tax law provides unscrupulous entities opportunities to abuse the tax system and commit fraud.”^[4] A third unstated, yet probable issue, is the apparent reluctance of the IRS to take on politically sensitive organizations. While the IRS is famously nonpartisan, even the most nonpartisan action can attract partisan attacks.^[5] It is notable that the New York Attorney General’s office has taken on the National Rifle Association, a section 501(c)(4) social welfare organization, but no sign that the IRS has taken any steps in that direction. The state action was filed in August of 2020 and the organization filed its Form 990 with the IRS in November 2020 reporting and admitting that there were substantial excess benefits to executives in 2019, and self-dealing by those same executives.^[6] Presumably the excess benefits and self-dealing have been occurring for quite some time.^[7] The New York Attorney General alleges in the New York state lawsuit that after an 18 month examination, they uncovered

(CONTINUED)

CLIENT ALERT: FEW TAX EXEMPT ORGANIZATIONS EXAMINED BY THE IRS

financial misconduct that resulted in the loss of more than \$64 million over a three year period.^[8] Will the IRS investigate? Only time will tell.

The IRS needs to be funded better and step up its compliance activities. If that is not possible, then it may be time to remove oversight of exempt organizations from the IRS and establish a separate nonprofit review agency within Treasury. That could encourage greater compliance by those who are tempted to cut corners, or even commit fraud, assuming there is adequate funding to reinvigorate the needed oversight. Law-abiding and conscientious charities, social welfare organizations and other types of tax-exempt organizations are put at a disadvantage if their “competition” is unscrupulous and engages in activities that are unseemly. These bad actors cast a dark cloud over the entire exempt organization community. All law-abiders would benefit from a more robust and better funded compliance initiative.

If the reader has any questions, please contact [Nancy Ortmeyer Kuhn](#), Esq. or another member of our [Tax Law Practice Group](#).

--

^[1] “Obstacles Exist in Detecting Noncompliance of Tax-Exempt Organizations”, Treasury Inspector General for Tax Administration, Report No. 2021-10-013 (February 17, 2021)(“[TIGTA Report](#)”)

^[2] E.g.: Form 990-PF; Form 990-EZ; Form 990-N, Form 990-T

^[3] See, I.R.C. §7611

^[4] TIGTA Report, supra at p. 4.

^[5] See “IRS Scandal Fast Facts”, [CNN](#) (September 22, 2020)

^[6] “NRA reports alleged misspending by current and former executives to IRS”, [Washington Post](#) (November 25, 2020)

^[7] “New York Attorney General moves to dissolve the NRA after fraud investigation”, [NPR](#) (August 6, 2020)

^[8] Id.

Client Alert: Few Tax Exempt Organizations Examined By the IRS

22 Feb 2021

The Treasury Inspector General for Tax Administration (“TIGTA”) recently issued a report about its review of the Internal Revenue Service’s (“IRS”) examination of tax-exempt organizations.^[1] (“TIGTA Report”) The TIGTA Report analyzed examinations conducted by the IRS during fiscal year 2019. TIGTA found that there are many obstacles to

(CONTINUED)

CLIENT ALERT: FEW TAX EXEMPT ORGANIZATIONS EXAMINED BY THE IRS

overcome in order for IRS' examiners to detect noncompliance by exempt organizations and churches.

In FY 2019, the number of organizations filing some type of Form 990^[2] was 1.5 million. The IRS examined approximately 2000 of those returns, or approximately 0.13%. An exempt organization's chance of being audited was 1 in 742. That doesn't even count churches, which are not required to file a Form 990. TIGTA reported a population of approximately 263,000 churches and other religious organization. These entities can be identified through filing of employment tax and other similar returns. Of the 263,000 identified churches and religious organizations, 39 religious entities were examined during FY 2019. That means a church has a 1 in 5,000 chance of being audited.

TIGTA noted that it is difficult to determine noncompliance based solely on the Form 990 and considered whether it would be useful to add more questions to Form 990. However, after review and discussions with IRS personnel, they decided not. Many of the examinations are started as a result of internal or external referrals: whistle-blowers. In fact, IRS' employees are encouraged to submit suggestions for possible examinations of exempt organizations via a separate online portal.

The lack of church examinations is understandable given there is no requirement for the church to provide the IRS with information through any type of information return. Congress has also provided a cumbersome and tedious process that the IRS must go through prior to opening an examination of a church.^[3] Frankly, examining even 39 religious entities is impressive given the many layers of obstacles. Separation of church and state is real, as envisioned by the U.S. Constitution.

Although 2,000 organizations had examinations initiated in FY 2019, the IRS closed 3,675 examinations during that year. Of those closed, 900 of the returns were reviewed but for a variety of reasons were closed without examination or even contact with the taxpayer. The reasons varied from short-term time periods due to a statute of limitations about to expire, insubstantial issues or issues without merit. Not stated, but what must surely be an issue, is the lack of funding and the lack of staffing devoted to oversight of tax-exempt organizations.

Without effective oversight of exempt organizations, and even churches, there is little motivation for compliance by those who are instead motivated to flaunt the law for their own benefit. Another reason for the lack of compliance, as stated in the TIGTA Report: "The complexity of the tax law provides unscrupulous entities opportunities to abuse the tax system and commit fraud."^[4] A third unstated, yet probable issue, is the apparent reluctance of the IRS to take on politically sensitive organizations. While the IRS is famously nonpartisan, even the most nonpartisan action can attract partisan attacks.^[5] It is notable that the New York Attorney General's office has taken on the National Rifle Association, a section 501(c)(4) social welfare organization, but no sign that the IRS has taken any steps in that direction. The state action was filed in August of 2020 and the organization filed its Form 990 with the IRS in November 2020 reporting and admitting that there were substantial excess benefits to executives in 2019, and self-dealing by those same executives.^[6] Presumably the excess benefits and self-dealing have been occurring for quite some time.^[7] The New York Attorney General alleges in the New York state lawsuit that after an 18 month examination, they uncovered financial misconduct that resulted in the loss of more than \$64 million over a three year period.^[8] Will the IRS investigate? Only time will tell.

The IRS needs to be funded better and step up its compliance activities. If that is not possible, then it may be time to remove oversight of exempt organizations from the IRS and establish a separate nonprofit review agency within Treasury. That could encourage greater compliance by those who are tempted to cut corners, or even commit fraud, assuming there is adequate funding to reinvigorate the needed oversight. Law-abiding and conscientious charities, social welfare organizations and other types of tax-exempt organizations are put at a disadvantage if their "competition" is unscrupulous and engages in activities that are unseemly. These bad actors cast a dark cloud over the entire exempt organization community. All law-abiders would benefit from a more robust and better funded compliance initiative.

(CONTINUED)

CLIENT ALERT: FEW TAX EXEMPT ORGANIZATIONS EXAMINED BY THE IRS

If the reader has any questions, please contact [Nancy Ortmeyer Kuhn](#), Esq. or another member of our [Tax Law Practice Group](#).

—

[1] “Obstacles Exist in Detecting Noncompliance of Tax-Exempt Organizations”, Treasury Inspector General for Tax Administration, Report No. 2021-10-013 (February 17, 2021) (“[TIGTA Report](#)”)

[2] E.g.: Form 990-PF; Form 990-EZ; Form 990-N, Form 990-T

[3] See, I.R.C. §7611

[4] TIGTA Report, supra at p. 4.

[5] See “IRS Scandal Fast Facts”, [CNN](#) (September 22, 2020)

[6] “NRA reports alleged misspending by current and former executives to IRS”, [Washington Post](#) (November 25, 2020)

[7] “New York Attorney General moves to dissolve the NRA after fraud investigation”, [NPR](#) (August 6, 2020)

[8] Id.

TAGGED: irs, tax exempt organizations, nonprofits, TIGTA, Form 990