

Remarks of Steven T. Miller  
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Thank you.

Lois Lerner has discussed several specifics today, so what I want to do is to talk more globally about what we are doing in the exempt organizations area and why we are doing it.

Let's start with two truisms – and as with any good debate, they are somewhat inconsistent. First, I believe that the overwhelming majority of the tax-exempt sector is composed of those who are well intentioned and who do the right thing.

My second truism – and the premise upon which I have based virtually all my decisions while managing our division – is that the Internal Revenue Service needs to re-establish itself in the tax-exempt community as an enforcement presence.

These two appear inconsistent, but you and I know they are not—for if we do not increase our presence, or better yet, convince you that we are on the job, then the first truism, which at its essence defines voluntary compliance, will fade. And if that happens, then both you and the Service will be forced to operate under very different and increasingly adversarial circumstances.

So let me tell you why we are concerned, what our overall strategy is to combat those concerns, and talk about some specifics on what we have done to date and what we plan for 2006.

What are our concerns? Well, there are at least two troubling trends in the tax-exempt sector. First, we have seen the migration of the governance problems that surfaced a few years ago in the corporate world. Weak governance and the resulting problems appear in the sector, evidencing themselves in such things as excess compensation and poor Form 990 reporting.

Second, we have seen unscrupulous persons starting to hijack charities and other non-profits to facilitate tax shelters, to promote self-interest, or to further profit-making enterprises.

Now, I do not believe it's too late to stop these trends, but when you combine them with the plummeting examination coverage we saw in the late 1990s and early into the new decade, it's clear we needed to act decisively. And we have done that.

My boss, IRS Commissioner Mark Everson, has led the effort, first by designating this area as one of his four Service-wide enforcement objectives, and second, by increasing our budget. The Exempt Organization's enforcement budget increased 23.5% in 2005, and we added 175 examination and other enforcement positions.

So how are we determined to reverse the erosion in compliance? How did we spend the increased budget? Well, we have two overarching strategic objectives that guide our planning, and they are very much related. The first is to increase transparency. The second is to effectively and efficiently increase our enforcement presence in the community.

Let's start with transparency. What do I mean by that term and why is transparency important? Transparency is the ability of an outside individual to accurately view the operations of an exempt organization. By increasing transparency we seek to get better information from you and the organizations you serve. At the start that information comes to us, but ultimately in our sector there is a component of transparency that makes information publicly available. Public availability will improve our ability to regulate and improve the efficiency of the sector as natural market forces operate.

Let's start our discussion of our efforts with regard to transparency with the Form 1023.

In 2004, we rolled out the new Form 1023, the application for exemption. It's longer than it used to be, and it is more tightly crafted to zero in on items about which we always had to ask follow-up questions.

From our perspective, at least to date, the new form has been a success. We are getting the information we need up front and are able to ask fewer follow-up questions.

Now, it's true that we still have staffing shortages, and that causes delays, but the new form has been a help. To increase transparency further, we hope, sometime in 2007, to begin making the application files of organizations that were granted exempt status, available for public

dissemination. We think this will be a great help for compliance purposes because the public – including watchdog organizations and the media – will be able to see what the organization promised to do to justify its exempt status.

Let me also discuss the Form 990, which is the lynchpin of any effort to enhance transparency. We made some changes for 2005, including changes in the part of the form related to compensation. And more changes are on the way. We are working on a more comprehensive revision of the 990.

Another key initiative to promote transparency has been our work on electronic filing. The 990, 990EZ and 990PF may now be filed electronically. This coming year we are requiring electronic filing for 2005 returns for very large organizations (those with total assets of \$100 million or more who file 250 returns) and for 2006 returns for mid-sized and larger organizations (those with 10 million or more in assets if they file at least 250 returns).

The message we'd like to get across is that electronic filing is easy to use, gives you instantaneous feedback in the form of acknowledgement of filing, and cuts down on correspondence between the Service and your organization. Please use it.

Also next year, in cooperation with the states, we hope to roll out the capacity for single point of filing, so that when you file with us, you file with your state as well.

In a further step to boost transparency, we recently began to image all 990s. Previously we only imaged forms for 501(c)(3)s. I believe that as this process gets underway, websites are likely to pick up these returns and make them easily available to the public. There should be a great deal of interest in some of the forms, including those of social welfare organizations.

That, in a nutshell, is how we are increasing transparency in the sector – our first strategic objective. We are not yet finished, but we are trying to get better and more information.

I talked about two strategic objectives – our second is to increase our enforcement presence.

We need to have a constant, visible, credible enforcement presence. We need to be back on the beat, and the public needs to know we are back.

Our intent is to create tension in the decision-making process and to influence behavior as people fill out their Form 990s. This tension, based on the knowledge that we are patrolling the beat, is intended to get people to do the right thing in advance of our having to show up in an enforcement role.

I want to divide my discussion of how we are enhancing our enforcement presence into two parts.

First, I want to discuss where we are in re-balancing our program, and I want to discuss how we have changed the way we approach enforcement.

Second, I want to talk about what I will call our critical enforcement initiative – and what we did in 2005 and plan for 2006.

So let's start with a report card on how we are doing on re-balancing. I give us high marks.

We have increased both the quantity and quality of our compliance relationships with the community. From 2003 to 2005 our Exempt Organizations enforcement contacts went up more than 57%. And we plan to boost those results by another 41% in 2006.

Now, let's be clear about terms. Enforcement contacts include new types of contacts in addition to traditional examinations. But even our traditional examinations are up during the same period, and will continue to rise.

Not only have we increased the number of contacts and examinations, we have also improved the types of cases we have in inventory. And to me the quality of the cases is more important than sheer numbers.

We have moved to more complex cases based on projects involving areas of abuse, rather than general program cases. This is how we do business now.

How have we done this?

Well, we have worked exceptionally hard to design and implement a coordinated group of new enforcement offices.

- The Financial Investigations Unit
- The Review of Operations Unit
- The expansion of the Exempt Organizations Compliance Unit, and
- The Data Analysis Unit

Let me talk briefly about each of these in turn. What I will describe is a full array of mutually supporting examination tools – each designed to deliver a specific compliance solution. We now have within Exempt Organizations an ability to respond flexibly and efficiently to individual exempt organizations, general trends and unique problems. We don't have to shy away from issues because they are too complex or too expensive, nor do we have to waste resources by overworking smaller problems that are efficiently solved through other than traditional examinations.

Let's start with the most complex financial cases that will now be worked in the Financial Investigations Unit. Schooled in forensic accounting, this unit focuses on money laundering, on fraud cases, and on terrorist financing.

The Review of Operations Unit tracks problematic organizations including the abusive relatively new organizations – “adolescents” if you will. It follows up on exempt organizations that have been designated as potential problems, most often those operating for a relatively short period of time that have been determined to be exempt solely on proposed activities. Its purpose is to insure that we keep organizations on our radar screen that we believe may have problems in the future.

The Exempt Organizations Compliance Unit is now a couple years old and permits us at a low cost to review a large number of returns and to correspond with taxpayers on what we find. This is for our least complex work, but also has been used to efficiently build cases for some of our most complex work as well. For the taxpayers involved, these compliance contacts are very real. They represent one-on-one interactions with the Service that require a response.

For example, we used the EOCU in our initiative on questionable compensation. This involved 1,250 individual contacts, as well as 800 exams, and we could not have undertaken a project of this size solely using traditional examination techniques and resources.

Finally, we have the Data Analysis Unit in its second year, a data-mining operation that mixes-and-matches data sets for better trend analysis and examination selection. We used it, for example, to compare a state's licensing database for bingo with gaming reports filed with us, and we found that the reporting is wanting. That becomes work for the EOCU.

That's a thumbnail sketch of the new way we are doing business and how we are expanding our enforcement coverage. No longer are we limited to use of traditional examinations.

Let's go to my second topic on enforcement, our critical initiatives. What did we pursue in 2005, and what are we looking at in 2006?

Well, we targeted our resources to a small number of critical compliance areas, applying our newly built tools. Let me mention a few – though I am sure Lois spoke to some of these:

**Compensation:**

We undertook almost 2,000 contacts in 2005. This includes both examinations and correspondence contacts. We raised questions about various subjects. We are not finished yet, but we already have found issues relating to proper reporting, loan transactions and examinations continue. It is our intention to issue a report in 2006.

We will also drill down in one or more market segments to increase our understanding of compensation practices, and to take action in the area of loans to insiders.

This compensation project also serves as a good example of how we will carry out initiatives in the future – using our data people, our compliance unit, and our agents and Washington specialists, as necessary.

**Credit Counseling:**

The second project I will mention is credit counseling. We have found real problems with credit counseling organizations, and our work in the area has been made all the more important by the passage of the new bankruptcy act, which requires people seeking bankruptcy protection to get counseling.

I raise this project as another model of how we will do business into the future – a very coordinated and strategically planned national effort. By the end of the year, it will lead to our proposing the revocation of tax-exempt status of 20 to 25 credit counseling organizations, representing perhaps as much as half the gross receipts of the credit counseling industry.

**Abusive Tax Avoidance Transactions:**

In 2005, we also focused on abusive tax transactions. We continue to work in several areas where abuses exist. That is not to say that all organizations in these categories are bad, but rather that, in some instances, we are seeing problems that need to be addressed. Many of these transactions are being actively promoted, and we are going after the promoters as well. The following are some focus areas:

- Donor Advised Funds
- Supporting Organizations

- Conservation Easements

For 2006, we will continue our work in this area and will do a project – in fact, a project across TE/GE – that will focus on how and why charities and others in the TE/GE community become involved in abusive transactions. We need to know why charities, some very well known, would accommodate or facilitate dubious transactions. That will be a focus area for 2006, as will our work on the resolution initiative just announced.

There is one other project I would like to touch on – our work on political activity. Last year we educated and communicated on this topic, but for the first time we did more. Where we had reason to believe there was a possible violation, we contacted those responsible.

Our view was that we needed to show an enforcement presence in this area. On the basis of what we have seen, and the number of complaints sent to us, it appears that the use of section 501(c)(3) organizations for political purposes has increased.

Well, we started the initiative, and eventually contacted more than 130 organizations, almost half of them churches. We are more than halfway finished, and most of the problems found seem to be one-time problems easily resolved. People ascribed all sorts of bad intentions to our actions at the start and they continue to do so, but we have found real problems. Any time you act in this area there will be a reaction.

All I can say is that our sole intention was and is to stem the use of charities for improper purposes and to enforce the prohibition against political intervention set out in the Code. And I can tell you – as shown by the Treasury Department Inspector General's report – that we were even-handed and thorough. We have found issues across the full political spectrum of organizations.

Let me wind up.

I have talked about re-balancing. But I want to end our discussion with something I hope will be reassuring.

Notwithstanding our ongoing efforts to change in order to expand transparency and enforcement, Exempt Organizations has a great tradition that will continue.

Part of that tradition is that EO has what I know to be among the best stakeholder relationships at the Service.

We have worked with you and with similar groups to broker an honest and open discussion of the issues, and that process has helped both of us time and time again.

A second aspect of the tradition is that we have always been concerned first about compliance and at best only second about revenue. We are most concerned about ensuring that you act in accordance with the purposes for which you are exempt. This perspective will not go away. Nor will our robust education and outreach programs. These programs will continue. Despite increased resources going to enforcement, we still went out to over 200 outreach events in 2005 and reached over 35,000 people. We also now have an e-mail service, as well, that you should sign up for.

So I want to assure you that we treasure our tradition and that we intend to protect it. Yes, we need to do more enforcement, but we will not let the message to re-balance get away from us.

Thank you for kind invitation and for giving me this opportunity to speak with you.