



## TAX EXEMPT & GOVERNMENT ENTITIES (TE/GE) BUSINESS OPERATING DIVISION

### FISCAL YEAR 2019 PROGRAM LETTER

#### MESSAGE FROM THE TE/GE COMMISSIONERS

This Program Letter shares with you where we are heading in the new fiscal year, including executing compliance strategies, building better processes, and providing useful information and guidance on the Tax Cuts and Jobs Act (TCJA). As we did last year, we will provide a full review of our FY 2018 accomplishments during the first quarter of FY 2019.

TE/GE has made tremendous progress in empowering our taxpayers with the launch of [Tax Exempt Organizations Search](#) (TEOS), more options to use [Pay.gov](#), the introduction of secure messaging with taxpayers and practitioners in our Tax Exempt Bonds (TEB) program, and additional guidance – including a number of innovative short videos – to make it easier for Indian Tribal Government (ITG) taxpayers and their representatives to understand and comply with the law. In FY 2019, we expect to expand our use of Pay.gov and our use of secure messaging with taxpayers and practitioners into our Employee Plans (EP) program. We also will continue an ambitious schedule of additional informational videos, articles and outreach events.

We continue to refine our compliance strategy approach, which is designed to ensure that TE/GE's examination programs are focused on the highest priority compliance areas to promote effective tax administration. Throughout FY 2018, TE/GE gained significant experience with the issue submission portal, developed compliance strategies and stocked our virtual shelf with approved compliance strategy cases. As we expected, FY 2018 was not without some growing pains. However, by the end of the year, we resolved many of these issues and will keep doing so in FY 2019.

TE/GE collaborates with our IRS business partners and various other groups and agencies, such as the Advisory Committee on Tax Exempt and Government Entities, the U.S. Department of Labor, the Municipal Securities Rulemaking Board, and the Securities and Exchange Commission. We work closely with our partners in law enforcement on high-profile tax fraud cases. Internally, we partner with other business units, including the Small Business/Self-Employed (SB/SE) Lead Development Center and the Servicewide promoter program to counter fraud and abuse. In FY 2019, our internal and external partnering efforts will expand to further educate taxpayers and help them to meet their tax obligations.

TE/GE leadership places a high priority on cultivating our workforce, which is our most important asset. TE/GE's Knowledge Management (KM) team has made significant enhancements to our Knowledge Networks (K-Nets) to make it easier for employees to search the K-Nets and find the resources they need. We also took steps in Exempt Organizations (EO) to provide "walk-in" assistance to consult with a subject matter expert on difficult technical issues. For the first time this decade, TE/GE is onboarding a significant number of new hires. In addition to bringing in the new hires and equipping them to engage fully in our work, we will continue to cross-train employees to allow flexibility in directing resources to shifting needs. In FY 2019, we will leverage our knowledge and experience to identify emerging issues and risks, and support employees in performing their jobs. We will do this by consistently providing high quality technical expertise through K-Nets and just-in-time training to support successful compliance strategies. K-Nets will focus on supporting our employees on compliance strategies with training, technical expertise and job aids. We plan to expand the "walk-in" approach beyond EO and will seek input on how to enhance our K-Net SharePoint sites and training.



*David W. Horton  
Acting TE/GE  
Commissioner*



*Robert S. Choi  
Acting TE/GE Deputy  
Commissioner*

## COMMISSIONERS' MESSAGE (cont.)

TE/GE continually seeks to advance data and analytics to drive decisions about identifying and addressing existing and emerging high-risk areas of noncompliance to which it applies optimal resources. TE/GE has partnered with Research, Applied Analytics, and Statistics (RAAS) to design and test data-driven approaches to identify noncompliance in both EO and EP. We also took some initial steps to introduce new tools to visualize data to make it easier to identify opportunities to enhance our operations throughout TE/GE. In FY 2019, our partnership with RAAS will expand to include testing new approaches to identify noncompliance in TEB. We also anticipate broadening access for our managers and analysts to new visualization tools, which are becoming an industry standard.

The TCJA will remain a priority in FY 2019. We have completed numerous form revisions, as well as guidance and training related to TCJA, and anticipate more developments in these areas going forward. It is imperative that we help taxpayers with their tax obligations, under both the new and pre-existing tax laws. We will initiate additional education efforts in FY 2019 along with TCJA-related compliance strategies.

In this new fiscal year, we will evaluate the six areas of our compliance program (defined on the following page) and identify opportunities to become more effective and efficient.

- As part of our compliance strategy process, we consider the most appropriate, cost-effective and least intrusive compliance treatments, including educational efforts, soft letter compliance reviews, compliance checks, and correspondence or field examinations. We will expand our capacity for highly efficient, low taxpayer-burden compliance checks with additional compliance units designed to be flexibly applied across TE/GE's compliance strategies, regardless of program.
- EO will encourage tax compliance for exempt organizations and federal, state and local governments through our examination programs. We will develop tools and educational resources to assist our stakeholders. We will continue to evaluate our determination processes to ensure we are operating in an efficient and effective manner. EO will hire and cross-train revenue agents to create an agile workforce so we can quickly allocate resources in response to inventory needs.
- EP will foster compliance through its robust voluntary corrections program, issue informal guidance in the form of Lists of Required Modifications (LRMs) to assist plan sponsors with plan document compliance and continue to update Fix-It Guides to assist with operational compliance. EP also will review input from the qualified plans community on the potential expansion of the scope of the determination letter program for amended individually designed plans (IDP) as well as the self-correction of plan qualification failures.

TE/GE's culture embraces change. We work in a dynamic environment, which we accept as a catalyst for innovation and improvement. We strive to ensure that tax-exempt and government entities are well-served and able to meet their tax responsibilities.

As always, we welcome your feedback and your support for effective tax administration.

Dave & Rob

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Compliance Strategies are issues approved by TE/GE’s Compliance Governance Board to identify, prioritize and allocate resources within the TE/GE taxpayer base. Using a web-based portal, TE/GE employees submit suggestions for consideration by the Board. Once approved, these issues are considered priority work. As more issues are developed and approved, those with a higher priority may potentially replace Compliance Strategies currently set forth in this document.	
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Referrals allege noncompliance by a TE/GE entity and are received from sources within and outside the IRS. Claims are requests for refunds or credits of overpayments of amounts already assessed and paid; they can include tax, penalties, and interest or an adjustment of tax paid or credit not previously reported or allowed.	
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## Compliance Strategies

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Compliance Strategies are issues approved by TE/GE's Compliance Governance Board to identify, prioritize and allocate resources within the TE/GE taxpayer base. Using a web-based portal, TE/GE employees submit suggestions for consideration by the Board. Once approved, these issues are considered priority work. Below we share some of the strategies that the Board has approved to date. As more issues are developed and approved, those with a higher priority may potentially replace Compliance Strategies currently set forth in this document. In this manner, TE/GE continuously ensures it is focused on the highest known priorities and emerging risks. If you are interested in learning more about the technical issues discussed below, search for the key term in the search box of the [IRS.gov](https://www.irs.gov) website.

## Exempt Organizations

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- Internal Revenue Code (IRC) Section 501(c)(7) entities: focus on investment income, non-member income and non-filers of Form 990-T, Exempt Organization Business Tax Return, by tax-exempt social clubs.
- IRC Section 4947(a)(1) Non-Exempt Charitable Trusts (NECTs): focus on organizations that under-report income or over-report charitable contributions.
- Previous for-profit: focus on organizations formerly operated as for-profit entities prior to their conversion to IRC Section 501(c)(3) organizations.
- Self-dealing by private foundations: focus on organizations with loans to disqualified persons.
- Early retirement incentive plans: determine whether federal, state or local governmental entities that provide cash (and other) options to employees as an incentive for early retirement have applied proper tax treatment to these benefits.
- Forms W-2/1099 matches: compare payments reported on Form 1099-Misc., Miscellaneous Income, with wages reported on Form W-2, Wage and Tax Statement, and subject to Federal Insurance Contribution Act (FICA) tax and income tax withholding.
- Notice CP 2100 (backup withholding): determine whether mismatched and/or missing taxpayer identification numbers on Form 1099 indicate failure to comply with backup withholding requirements.
- Worker classification (misclassified workers): determine whether misclassified workers result in incorrectly treating employees as independent contractors.

## Employee Plans

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- Distributions: verify that plans are following correct distribution processes and procedures and that participants are receiving correct distribution amounts.
- Form 5500, Annual Return/Report of Employee Benefit Plan, and Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan, stop filers: contact employers sponsoring plans that did not file one or more required returns.
- IRC Section 403(b)/457 plans: examine 403(b) plans for universal availability, excessive contributions and proper use of catch-up contributions under IRC Section 414(v); and 457(b) plans for excessive contributions and proper use of the special three-year catch-up contribution rule.
- Small plans with large assets: determine whether smaller plans with trusts holding large assets have taken deductions on Form 1120, U.S. Corporation Income Tax Return, exceeding IRC Section 404 limitations.
- Simplified Employee Pension (SEP) plans: determine whether accounts violated maximum participant rules, failed to meet statutory and matched employer contribution requirements, and/or failed to meet IRC Section 416(i)(6) top-heavy requirements.
- Terminated cash balance plans: examine terminated plans with cash balance features that may have exceeded IRC Section 415 limitations or generated a reversion which is subject to an excise tax.

### Indian Tribal Governments/Tax Exempt Bonds

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- Cost of issuance: determine whether the costs of issuance (COI) on private activity bonds exceeds 2 percent of the proceeds of the issue, which adversely affects the tax-exempt status of the bond.
- Forms W-2/1099 matches: determine whether payments reported on Form 1099 should have been treated as wages reported on Form W-2 and, therefore, subject to FICA tax and income tax withholding.
- Notice CP 2100 (backup withholding): entities may have failed to comply with backup withholding requirements due to mismatched and/or missing taxpayer identification numbers on Form 1099.
- Notice of defeasance: bond issuers may have taken remedial actions under (1) Treasury Regulation Section 1.141-12, or (2) Treasury Regulation Section 1.142-2 without meeting all requirements under the applicable regulations.
- Public safety bonds: determine whether federal government use and management contracts cause excessive private business use that adversely affects the tax-exempt status of public safety bonds.

### Data-Driven Approaches

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Data-Driven Approaches use data, models and queries to select work based on quantitative criteria, which allows TE/GE to allocate resources that focus on issues that have the greatest impact. TE/GE is committed to integrating data into its processes and procedures, and will use return data and historical information to identify the highest risk areas of noncompliance.

### Exempt Organizations

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- Models: continue to improve compliance models based on Form 990, Return of Organization Exempt From Income Tax; Form 990-EZ, Short Form Return of Organization Exempt From Income Tax; and Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation; and test the newly developed model for Form 5227, Split Interest Trust Information Return. Also, identify returns of exempt organizations and government entities containing the highest risk of employment tax noncompliance (e.g., substantial credit balances with no returns or zero to minimal Medicare and/or Social Security wages paid compared to Form 1099 distributions).
- RAAS collaboration: continue to review various items and activities, including private benefit/inurement, officer business partnerships, underreported credit card income, and related employees and for-profit partnerships.

### Employee Plans

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- RAAS collaboration: sample the results of data queries and models to test indicators of noncompliance for various plan types (e.g., profit sharing, money purchase, 401(k) and defined benefit).

### Indian Tribal Governments/Tax Exempt Bonds

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- RAAS collaboration: continue to develop models for Form 8038, Information Return for Tax-Exempt Private Activity Bond Issuers, and Form 8038-G, Information Return for Tax-Exempt Government Obligations, by sampling the results of data queries and models designed to test indicators of noncompliance.

### Referrals, Claims and Other Casework

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Referrals allege noncompliance by a TE/GE entity and are received from internal and external sources. Claims are requests for refunds or credits of overpayments of amounts already assessed and paid; they can include tax, penalties, and interest or an adjustment of tax paid or credit not previously reported or allowed. The public can submit a referral on individuals or businesses on [Form 3949-A](#), Information Referral, or submit a specialized EO referral on [Form 13909](#), Tax-Exempt Organization Complaint.

#### Exempt Organizations

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- Referrals: continue to pursue referrals received from internal and external sources that allege noncompliance by an exempt organization, and pursue taxpayer and interagency referrals, including information items from sources within and outside the IRS that allege noncompliance with employment tax law by a government entity or an exempt organization.
- Claims: continue to address requests for refunds or credits of overpayments of amounts already assessed and paid, including tax, penalties, interest, or an adjustment of tax paid or credit not previously reported or allowed; and also continue to address high-dollar, complex employment tax claims filed by federal, state and local governments.
- Other casework: continue to examine entities that filed and received exemption using Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. The scope of these exams will include (1) filers who are ineligible to file Form 1023-EZ, (2) filers who donate to (or pay expenses for) individuals, and (3) filers operating bingo or other gaming activities. Additionally, support Servicewide compliance efforts on IRC Section 4980H with respect to certain exempt employers.

#### Employee Plans

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- Referrals: continue to pursue referrals received from internal and external sources that allege possible noncompliance by a retirement plan.
- Claims: continue to address requests for refunds or credits of overpayments of amounts already assessed and paid. These claims can include tax, penalties, and interest or they can also be a request for an adjustment of tax paid or credit not previously reported or allowed.
- Other casework: continue to address requests from plan sponsors to waive their minimum funding requirement for a plan year, review non-bank trustees (NBT) to verify that they have satisfied the NBT regulations and pursue promoter investigations.

#### Indian Tribal Governments/Tax Exempt Bonds

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- Referrals: continue to prioritize referrals received from internal and external sources warranting examination resources that allege possible noncompliance by an ITG or TEB entity.
- Claims: continue to address claims for overpayment of rebates and claims for credit payments on Direct Pay Bonds, as well as employment tax claims filed by an ITG.
- Other casework: continue to maintain the program to ensure tip reporting compliance of ITG entities and their tipped employees, including (1) securing tip agreements, (2) refreshing expiring tip agreements, (3) revoking tip agreements on non-compliant agreement holders, and (4) conducting tip examinations for entities with low tip reporting and no tip agreements. In addition, ITG/TEB will continue, in appropriate circumstances, to convert casinos using the Tip Rate Determination Agreement (TRDA) to the industry-specific Gaming Industry Tip Compliance Agreement (GITCA). ITG/TEB will conduct tip compliance reviews for entities failing to comply with year-end reporting requirements.



### Compliance Contacts

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Compliance Units are employed to address potential noncompliance, primarily using correspondence contacts known as “compliance checks” and “soft letters.”

A compliance check is correspondence with organizations to inquire about an item on a filed return; to determine if specific reporting requirements have been met; or to determine whether an organization’s activities are consistent with its stated tax-exempt purpose. A compliance check is not considered an examination.

A soft letter is correspondence with organizations that provides notification of changes in tax-exempt law or compliance issues. A response to these letters is not expected. However, responses may be received and converted into a compliance check. These contacts allow TE/GE to establish a presence in the taxpayer community in a manner that reduces burden to the taxpayer and cost to the IRS.

TE/GE will continue to inform taxpayers via compliance checks and soft letters on issues of noncompliance, while seeking to improve return filings and filing accuracy, as described below:

- To determine whether an exempt organization, Indian tribal government, or federal, state and local governmental entity is adhering to recordkeeping and information reporting requirements, including:
  - Combined Annual Wage Reporting (CAWR) Employment Tax: tax-exempt employers that had discrepancies between Form W-2 and either Form 941, Employer’s Quarterly Federal Tax Return, or Form 944, Employer’s Annual Federal Tax Return.
  - CAWR – Federal Unemployment Tax Act (FUTA): exempt organizations that are required to, but fail to file Form 940, Employer’s Annual Federal Unemployment Tax Return.
  - Financial Assistance Policy (FAP): tax-exempt hospital organizations that did not comply with IRC Section 501(r)(4).
  - Form 990-T Non-Filer: IRC Section 501(c)(7) organizations that reported investment income on Form 990/990-EZ but did not file Form 990-T.
  - Form 1099 Stop-Filer: entities that were required to file, but fail to file Form 1099-Misc.
  - IRC Section 501(c)(12) Mutual or Cooperative Telephone Companies: organizations that may have failed to meet the 85 percent member income test.
  - IRC Section 4947(a)(1) Non-Exempt Charitable Trusts (NECTs): exempt organizations that are required to file, but fail to file Form 1041, U.S. Income Tax Return for Estates and Trusts.
  - Supporting Organizations: entities that state they are supporting organizations but they have filed Form 990-N, Annual Electronic Filing Requirement for Small Exempt Organizations.
- To determine whether a retirement plan is adhering to recordkeeping and information reporting requirements, including:
  - Deductions in excess of 25 percent of compensation.
  - Voluntary compliance (VC) 150-day compliance statement follow-ups.
  - SEP-IRA plans with required minimum distribution failures.
  - Stop filers of Form 5500/5500-SF.



### Determinations

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Determination letters are issued to exempt organizations on exempt status, private foundation classification and other determinations relating to exempt organizations, and to retirement plans that satisfy the qualification requirements of federal pension law.

EO expects a continued increase in determination applications and will concentrate on identifying new strategies for reducing filing burden and case processing time. EO will also hire approximately 40 new revenue agents to process determination applications to help offset application increases and workforce attrition.

EP will continue to accept individually designed plan (IDP) applications for both initial plan and terminating plan submitters. EP continues to review input from the qualified plans community on the potential expansion of the scope of the determination letter program for amended IDPs. The due date for defined contribution pre-approved plans (PAP) is December 31, 2018. Employee Stock Ownership Plans (ESOPs) will be permitted under the PAP program for the first time.

### Voluntary Compliance and Other Technical Programs

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VCP enables a plan sponsor (at any time before audit) to pay a fee and receive IRS approval for correction of plan failures. KM works to ensure the quality and consistency of technical positions, provide timely assistance to employees, and preserve and share TE/GE's knowledge base.

EP is exploring implementation of a fully electronic submission process for VCP. If successful, we will publicize the changes through (1) communications with the plan sponsor and pension practitioner communities, and (2) updates to the Employee Plans Compliance Resolution System (EPCRS) revenue procedure. EP continues to review input from the qualified plans community on the potential expansion of self-correction of plan qualification failures under the EPCRS program.

In addition, EP will focus on actuarial letter rulings, 60-day rollover waivers and technical assistance work for its taxpayers.