

Tax Exempt and Government Entities FY 2018 Work Plan

September 28, 2017

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Message from the TE/GE Commissioners



Sunita Lough,
Commissioner

We enter Fiscal Year 2018 as a more cohesive and efficient division than we were even a year ago, and we remain grounded in the same values and vision we started with in January 2014. Continuous improvement, data-driven decision making, risk management, employee engagement and knowledge management continue to be the foundation of our work. Yes, we've come a long way, yet there's a consistent thread running through these years in terms of our strategy to refine, realign and improve. So now here we are at FY 2018, positioned to implement some exciting changes.



David Horton,
Deputy
Commissioner

The look and feel of TE/GE, as well as the processes we're beginning to implement, have been germinating for about three and a half years. In FY 2018, they'll bear fruit. That's thanks to each of you, the Lean Six Sigma Office, and support from the IRS leadership. And, not coincidentally, where we are today meshes with the Service-wide Future State strategy.

To a degree, this is a creative response to the IRS's and TE/GE's declining workforce, as well as our strategic imperatives. The centerpiece of this transition is our recent realignment of certain staff resources and the unveiling of a more centralized, sophisticated approach to compliance. On May 1, 2017, we brought online a new Compliance, Planning & Classification (CP&C) unit, streamlining and consolidating processes occurring in functions within TE/GE. CP&C embodies a more comprehensive approach to identify, research, and monitor compliance risks, using data analytics. In FY 2018 we will launch the Compliance Strategy Tool and an Internal Submission Portal, to collect, or "crowdsource," your input into areas of non-compliance. This input and collaboration among issue experts (whether in CP&C, the field, or the K-Nets) and data analysts will be critical to determining our Compliance Strategies in the coming years. A new governance board will review recommended Compliance Strategies and determine which of those to pursue.

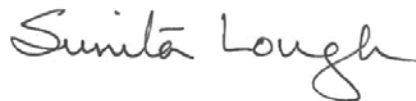
As part of the realignment, we have consolidated some elements of TE/GE – Indian Tribal Governments (ITG) and Tax Exempt Bonds (TEB) have been grouped into one function (ITG/TEB) and Federal, State and Local Governments (FSLG) has been moved into Exempt Organizations and will now be referred to as Federal, State, Local / Employment Tax (FSL/ET). These changes have no effect on tax provisions, the

importance of the work performed by the employees or the taxpayers we serve. In addition, we have realigned closing units and special review functions under CP&C.

The realignment was a heavy lift and required detailed attention to every facet of our work. A change of this magnitude required assistance from every function in TE/GE, including a strong partnership with our external stakeholders, especially NTEU. Thanks to all of you for your resilience in seeing this through to completion.

We encourage you to read the functions' briefing documents below, which demonstrate in more detail how our new direction is playing out in the determinations area as well as examinations. Complete FY 2017 accomplishments will be released as a separate document in January 2018, when final results become available.

Last year's Program Letter stressed *efficiency, effectiveness and transparency* as key elements of our endeavors. Those remain our bywords going forward. Our sincere thanks go to you. You are the ones who make this possible.



Commissioner, TE/GE



Deputy Commissioner, TE/GE

Exempt Organizations

Fiscal Year 2017 Accomplishments

Exempt Organizations (EO) implemented several processing changes to better serve EO customers and assist employees to more efficiently process applications for tax-exempt status, as described below:

- Modified certain eligibility criteria for Form 1023-EZ in [Revenue Procedure 2017-5](https://www.irs.gov/irb/2017-01_IRB/ar11.html) (https://www.irs.gov/irb/2017-01_IRB/ar11.html). Organizations exempt under a subsection other than IRC section 501(c)(3) are no longer eligible to use Form 1023-EZ to apply for recognition of exemption under IRC section 501(c)(3). Also, an organization may not submit a Form 1023-EZ if it has submitted a Form 1023 that is pending.
- Realigned the cross-functional Employment Tax Knowledge Network (K-Net) with the other five EO K-Nets. EO K-Nets created [issue podcasts](https://www.stayexempt.irs.gov/home/resource-library/issue-podcasts) (<https://www.stayexempt.irs.gov/home/resource-library/issue-podcasts>) (i.e., short, on-demand presentations that include a summary and analysis of issues as well as references to key resource materials) for employees. EO also created and posted new [issue snapshots](https://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots) (<https://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots>) for charities and non-profits. These snapshots are aids that provide analysis and resources on technical tax issues.
- Issued proposed adverse determination letters to organizations that did not provide complete responses to requested information. This allows the organization to protest the proposed adverse determination and exercise its right to appeal the determination to the Office of Appeals.

EO continued to process Form 8976, *Notice of Intent to Operate Under Section 501(c)(4)*, as required by the Protecting Americans from Tax Hikes Act of 2015 ([the PATH Act](https://www.irs.gov/charities-non-profits/electronically-submit-your-form-8976-notice-of-intent-to-operate-under-section-501c4), <https://www.irs.gov/charities-non-profits/electronically-submit-your-form-8976-notice-of-intent-to-operate-under-section-501c4>). Since implementation, 17 percent of the Form 8976 notices were rejected. The most common reasons for rejection were non-payment of the user fee and pre-existing exemptions (so notifications were not required).

In May, EO Examinations welcomed specialists from the Federal, State, and Local (FSL) government function. The addition of these specialists will allow EO to leverage and centralize TE/GE's employment tax (ET) knowledge and achieve efficiencies in examining ET issues within the tax-exempt and government entities sector.

Fiscal Year 2018 Rulings & Agreements

EO expects to receive an increased number of determination applications in FY 2018. In early 2018, EO will implement revisions to the Form 1023-EZ, including a required activity description and additional questions on gross receipts, asset thresholds, and foundation classification. As a result of these changes, EO expects the average processing time for a Form 1023-EZ to increase. EO will continue pre-determination reviews of a statistical sample of Form 1023-EZ applications and will continue to analyze the data from these applications to mitigate risks and identify opportunities to improve this form and its instructions.

EO will also implement enhancements to the Form 8976 submission platform to reduce the number of rejections due to non-payment of the required user fee.

Exempt Organizations (cont.)

Knowledge Management (KM)

EO will continue to produce high-quality technical KM products (e.g., issue snapshots and audit tools) and integrate the K-Nets with new Compliance Strategies. Planned topics include issues involving gaming, unrelated business income (and related exemption issues), IRC section 501(r), organizational test requirements, and employment tax. EO will also continue to work on removing technical information, such as summaries of Revenue Rulings and court cases, from the Internal Revenue Manual and placing them on the [Audit Technique Guides \(ATGs\) for Exempt Organizations webpage](https://www.irs.gov/charities-non-profits/audit-technique-guides-atgs-for-exempt-organizations) (<https://www.irs.gov/charities-non-profits/audit-technique-guides-atgs-for-exempt-organizations>).

Fiscal Year 2018 Compliance Program

Compliance Strategies:

- Supporting organizations: examine entities that state they are supporting organizations and filed the Form 990-N.
- Previous for-profit entities: examine organizations that operated as for-profit entities prior to their conversion to IRC section 501(c)(3) organizations.
- Private benefit and inurement: examine organizations which show indicators of potential private benefit or inurement to individuals or private entities.

Data-driven approaches:

- Models: continue to improve Form 990, 990-EZ, and 990-PF compliance models and test the newly developed model for Form 5227, *Split Interest Trust Information Return*.
- Private foundations: continue to examine private foundations based on potential anomalies found on their Form 990-PF filings.

Referrals, claims, and other casework:

- Referrals: continue to pursue referrals received from sources within and outside the IRS that allege non-compliance by an exempt organization.
- Claims: continue to address requests for refunds or credits of overpayments of amounts already assessed and paid, including tax, penalties, and interest or an adjustment of tax paid or credit not previously reported or allowed.
- Post-Determination Compliance: examine entities that filed and received exemption using the Form 1023-EZ. In addition, EO will examine entities that were granted exemption through the streamlined review of their Form 1023.
- Statistical sample: examine returns filed by exempt organizations to ensure comprehensive compliance coverage of this universe.

Exempt Organizations (cont.)

Compliance checks:

EO will continue to use compliance checks to determine whether an entity is adhering to recordkeeping and information reporting requirements. Compliance checks include:

- Combined Annual Wage Reporting (CAWR) employment tax: tax-exempt employers that had discrepancies between Form W-2 and Form 941/944;
- CAWR – Federal Unemployment Tax Act (FUTA): exempt organizations that are required to, but fail to file Form 940;
- 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; and
- Financial Assistance Policy: tax-exempt hospital organizations that did not comply with IRC section 501(r)(4).

Federal, State, and Local/Employment Tax (FSL/ET)

FSL/ET examiners will continue to focus on compliance by federal, state and local government entities with their employment tax obligations. In addition, FSL/ET examiners will assist with the examination of tax-exempt entities with complex worker classification and/or complex fringe benefit issues.

Compliance Strategies:

- Early retirement incentive plans: examine entities that provide cash (and other) options to employees as an incentive for early retirement to determine if the proper tax treatment was applied to these benefits.
- Form W-2/1099 matches: examine entities where payments reported on Forms 1099 should have been treated as wages subject to Federal Insurance Contribution Act (FICA) tax and income tax withholding.
- FUTA tax: address situations where an IRC section 501(c)(3) organization handles payroll that includes employees of a related IRC section 501(c)(4) organization, but does not pay the FUTA tax on the employees of that IRC section 501(c)(4) organization.
- Notice CP 2100 - backup withholding: examine entities that failed to comply with backup withholding requirements due to mismatched and/or missing Taxpayer Identification Numbers on Form 1099.

Data-driven approaches:

- Models: identify returns filed by exempt organizations and government entities with the highest risk of ET non-compliance (e.g., substantial credit balances with no returns, and zero to minimal Medicare and/or Social Security wages paid compared to Form 1099 distributions).

Referrals, claims, and other casework:

- Referrals: pursue taxpayer and interagency referrals, including information items from sources within and outside the IRS that allege non-compliance with a tax law by a government entity or an exempt organization.

Employee Plans

Fiscal Year 2017 Accomplishments

Employee Plans (EP) implemented several program and processing changes to better serve EP customers and assist employees with their cases, as described below:

- Implemented changes to the EP determination letter program that included the elimination of the five-year remedial amendment cycle system for Individually Designed Plans starting in January 2017. As a result, EP expects to receive fewer applications in FY 2018.
- Issued two directives using the Industry Issue Resolution program that provide substantiation guidelines to agents examining whether a hardship distribution by an IRC section 401(k) plan or an IRC section 403(b) plan is deemed to be on account of an immediate and heavy financial need under safe-harbor standards in the regulations.
- Issued two directives that addressed the maximum plan loan amount for participants with multiple loans and the application of the *definitely determinable* rule to cash balance plans.
- Streamlined the process for working EP Voluntary Compliance (VC) cases and converted paper case files to an electronic case management system. The streamlined process will allow EP to provide timely service to employee plan sponsors who have provided all the necessary information to develop and resolve their VC requests.
- Created and posted [issue snapshots](https://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots) (<https://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots>) for retirement plans. These snapshots are aids that provide analysis and resources on technical tax issues.

Fiscal Year 2018 Rulings & Agreements

For Individually Designed Plans, EP Determinations will accept only initial and terminating Individually Designed plan applications (i.e., no amendments). In the first quarter of FY 2018, EP will begin receiving applications for defined contribution specimen plans as part of the Pre-Approved Plan (PAP) program. The due date for these plans is now October 1, 2018. Employee Stock Ownership Plans (ESOPs) will be permitted under the PAP program for the first time in FY 2018. In addition, EP Determinations will issue approval letters for the defined benefit PAP specimen plans in the second quarter.

Knowledge Management (KM)

EP will continue to produce high-quality technical KM products (e.g., issue snapshots and audit tools) and integrate the K-Nets with new Compliance Strategies. Planned topics include issues involving: qualification requirements for defined contribution church plans; the application of new regulations regarding qualified non-elective and qualified matching contributions; the availability of single-sum distribution options; the use of all three segment rates to credit interest in a cash balance plan; and the treatment of excess contributions in Simplified Employee Pension (SEP) plans.

In addition to managing the EP K-Nets, EP Technical will also focus on actuarial letter rulings, 60-day rollover waivers, opinion letters on prototype Individual Retirement Account (IRA) products, and technical assistance work for its taxpayers

Employee Plans (cont.)

Voluntary Compliance Program

EP will provide online guidance to the public on practices that facilitate quick closures of VC applications with the expectation that more taxpayers/practitioners will use this information to perfect their applications before submission. Additionally, EP will focus efforts on analyzing issue/failure trends to inform its Knowledge Management program and to better refine outreach and other communications on areas of non-compliance.

Fiscal Year 2018 Compliance Program

Compliance Strategies:

- Mergers/consolidations: examine plans that have transferred their assets or liabilities to another plan as the result of a merger or acquisition.
- Discrimination: examine plans that failed to comply with the *gateway test* or the exception under section 1.401(a)(4)-8(b) of the regulations, failed both the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests, failed to properly provide timely notice to participants, and/or failed to provide the required safe harbor contribution to all eligible participants.
- Participation/coverage: examine plans that failed to satisfy the minimum age and/or service requirements, met statutory requirements in form but failed eligibility in operation, and/or allowed ineligible participant(s) to participate.
- Distributions: examine plans that failed to make required distributions under IRC section 401(a)(9), failed to distribute per plan terms (either in timing or form), and/or failed to distribute the correct benefit amount.
- Trust investments in small plans: examine plans that failed to properly value all assets at fair market value and/or failed to properly reflect all plan assets in the name of the trust (e.g., real estate investments).
- Benefit accruals: examine plans that failed to satisfy IRC section 411(b) accrual rules.
- Contributions/earnings allocations: examine plans that made erroneous allocations of contributions and/or forfeitures due to the use of an incorrect definition of compensation and/or failed to make all matching contributions per plan terms.
- Elective deferrals: examine plans that failed to withhold the proper amount of elective deferrals per plan terms.

Data-driven approaches:

- Models: continue to examine various plan types (e.g., profit sharing, money purchase, IRC section 401(k), defined benefit) with returns selected by sampling the results of data queries and models designed to test indicators of non-compliance.

Employee Plans (cont.)

Referrals, claims, and other casework:

- Referrals: continue to pursue referrals received from sources within and outside the IRS that allege possible non-compliance 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 also be a request for an adjustment of tax paid or credit not previously reported or allowed.
- Multiemployer plans: continue to examine plans that failed to properly calculate retirement benefits affecting service crediting and/or allocation/accruals, failed to make required minimum distributions, and/or failed to adjust benefits when retirement is delayed beyond the Normal Retirement Age.
- IRC section 403(b)/457 plans: continue to examine plans that failed to meet Universal Availability requirements (i.e., coverage for salary deferrals), failed to meet contribution limitations (i.e., IRC section 414(v) – age 50 and/or 15-year special catch-up contributions), and/or made improper hardship withdrawals.
- IRA plans: continue to examine plans that 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.
- Additional casework: continue to address requests from plan sponsors to waive their minimum funding requirement for a plan year, investigate (not examine) Non-Bank Trustees (NBT) to verify that they have satisfied the NBT regulations, and pursue promoter investigations.

Compliance checks:

EP will continue to use compliance checks to determine whether a plan is adhering to recordkeeping and information reporting requirements. Compliance checks include:

- Plans with partial terminations;
- Plans with non-participant loans;
- IRC section 403(b) plans;
- IRC section 457(b) plans with excess deferrals;
- SEP plans with required minimum distribution failures; and
- SIMPLE IRA plans sponsored by more than 100 employees.

Indian Tribal Governments/Tax Exempt Bonds

Fiscal Year 2017 Accomplishments

As part of its reorganization, TE/GE combined the Indian Tribal Governments (ITG) and Tax Exempt Bonds (TEB) functions. The scope and mission of a combined ITG/TEB will remain the same as it was for the separate functions: administer federal tax laws applicable to tax-advantaged bonds and assist Indian Tribes with addressing their federal tax matters. ITG/TEB made other program and procedural improvements, as described below:

- Completed several educational tools and content enhancements for its customers, including updating Publication 4268, *ITG Employment Tax Desk Guide*, and creating self-help recordings for individual Tribal member issues. ITG/TEB also developed training tools for Collection employees working with Tribal customers.
- Increased use of focused examinations to improve audit efficiency by emphasizing examinations that provide the greatest impact on potential non-compliance. Data collection tools and data analytics are now central to improved case selection.
- Conducted Knowledge Network (K-Net) events for employees on recent changes to regulations affecting arbitrage, safe harbors for management contracts, and issue price. ITG/TEB also created and posted new [issue snapshots](https://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots) (<https://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots>) for tax-advantaged bond issuers. These snapshots are aids that provide analysis and resources on technical tax issues.

Fiscal Year 2018 Technical

Knowledge Management (KM)

ITG/TEB will continue to produce high-quality technical KM products (e.g., issue snapshots and audit tools) and integrate the K-Nets with new Compliance Strategies.

Planned ITG topics include issues involving: IRC section 7871 – Tribes treated as states; IRC section 7873 – fishing-related income; IRC sections 3306 and 3309 – Federal Unemployment Tax Act (FUTA) exception; Revenue Ruling 59-354 – Tribal council member's pay; IRC section 414(d) – governmental plans for Tribes; withholding agents Form 1042-S; Foreign Person's U.S. Source Income Subject to Withholding issues; Gaming Industry Tip Compliance Agreements (GITCA)/Tax Rate Determination Agreements (TRDA) tip agreements; and fraud-related audit techniques.

Planned TEB topics include issues involving: hedge terminations; economic life and weighted average maturity (WAM); safe harbors for guaranteed investment contracts; and rules for qualified hedges.

ITG/TEB will also use the K-Net platform to facilitate technical/emerging issue updates and coordination meetings.

Indian Tribal Governments/Tax Exempt Bonds (cont.)

TEB Voluntary Closing Agreement Program (VCAP)

ITG/TEB will work to further streamline review and processing requests for TEB VCAP to enable resolution with minimal IRS and issuer resources. For example, ITG/TEB is working to develop a self-remediation mechanism to help resolve certain arbitrage violations.

Customer education and outreach

ITG/TEB plans to devote resources to customer education and outreach efforts at levels similar to prior years. These efforts are focused on virtual outreach contacts, such as webinars and web-based educational resources. ITG/TEB will emphasize developing resources for Tribal customers, including:

- Releasing a 13-session DVD-based basic payroll tax mini-course for distribution to Tribes with weak and/or intermittent internet connectivity.
- Releasing an internet-based interactive tool to provide real-time guidance for casino tax issues (i.e., reporting of gaming winnings, tipped employees, and anti-money laundering (Title 31)).
- Inaugurating a series of webinars by collaborating with Treasury Tribal Advisory Committee (TTAC) leaders to provide substantive updates and increase IRS credibility in Indian Country.
- Continuing to revise content on the IRS website, including finishing two interactive forms (Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, and Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*) and updating existing online videos and educational materials for Tribal customers.

Fiscal Year 2018 Compliance Program

Compliance Strategies:

- Arbitrage: examine tax-advantaged bonds with guaranteed investment contracts and/or qualified hedges as well as bonds with investments beyond a temporary period.
- Acquisition financing: examine private activity bonds to determine whether the rehabilitation requirement was satisfied.
- Non-qualified use: examine dispositions of financed facilities and/or excessive private business use.
- Other Compliance Strategies: examine bonds issued with a deep discount and private activity bonds with excessive weighted average maturities.

Data-driven approaches:

- Models: continue to examine Indian Tribes and tax-advantaged bonds with returns selected by sampling the results of data queries and models designed to test indicators of non-compliance.

Indian Tribal Governments/Tax Exempt Bonds (cont.)

Referrals, claims, and other casework:

- Referrals: continue to prioritize referrals received from sources within and outside the IRS warranting examination resources that allege possible non-compliance by a Tribal entity or a bond issuer.
- 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 exempt organizations, Federal, state, and local governments, and Indian Tribes.
- Tip compliance: continue to maintain the program to oversee tip wages received by employees of ITG entities. Tip compliance begins with refreshing expiring tip agreements, revoking tip agreements on non-compliant agreement holders, and conducting tip examinations for entities with low tip rates and no tip agreements. Additionally, ITG/TEB plans to complete the conversion of TRDA to the more appropriate GITCA. ITG/TEB will assign tip compliance reviews for entities that have problems with year-end reporting, such as incorrect rates, categories, and/or under-reporting. To encourage compliance for tipped Tribal casino employees, ITG/TEB will continue to identify non-compliant employees for two other IRS programs (worked by the Small Business/Self-Employed division (SB/SE)) that focus on casino employee tip reporting: the individual tip exam program and the individual tip soft notice program.

Compliance checks:

ITG/TEB will continue to use compliance checks to determine whether an entity is adhering to recordkeeping and information reporting requirements. Compliance checks include:

- Tribal casino-based Bank Secrecy Act (BSA) information for casinos not selected for BSA examination;
- Small Indian Tribal entities that have not had any other compliance contact on a five-year rotating basis; and
- Employment tax returns of small Federal, state, and local governments and tax-exempt organizations