

Exempt Organizations Nonfiler Study

**Report of Findings
December 1994**

Assistant Commissioner
Employee Plans & Exempt Organizations

Internal Revenue Service

EXECUTIVE SUMMARY

Background

During the 1993 Ways and Means Oversight Subcommittee hearings on exempt organization matters, concerns were raised regarding the accuracy of data on the Exempt Organizations/Business Master File (EO/BMF). Specifically, the Committee was concerned with the Service's procedures for capturing information on small organizations whose annual gross receipts are under the \$25,000 Form 990 filing threshold. Shortly after the hearings, a survey conducted by the Mellon Foundation concluded that up to 40 percent of the small organizations on the EO/BMF may no longer be in existence.

In an effort to determine the accuracy of the data on the EO/BMF for organizations coded as *not required to file*, an EO nonfiler team was formed. The team obtained a statistically valid sample of 300 organizations coded as not required to file returns and referred them to the field for examination under the Office/Correspondence Examinations Program (OCEP). The results are summarized below.

Findings:

- Seventy-two percent of the 300 organizations selected for the study continue to be active and are properly classified as flog required to file on the EO/BMF.
- Nearly fourteen percent of the organizations had terminated their activities.
- Seven percent of the organizations could not be located after exhaustive searches by our agents.
- Approximately three percent of the organizations became required to file Form 990 returns during the course of the study (gross receipts exceeded \$25,000), and did voluntarily file Form 990 prior to being contacted by the Service.
- Two percent of the organizations were liable for filing Form 990s, but did not do so (delinquent filers).
- Five of the organizations selected as part of the study (two churches and three state chartered credit unions) had been miscoded on the EO/BMF.
- Thirty-three percent of the organizations located had EO/BMF data errors other than their filing status (e.g., address, name, EIN), and multiple data errors were found in six percent of the cases.
- Information received from the organizations that were located revealed that in about 24 percent of the cases the person responsible for maintaining the organization's books and records was unaware of the obligation to file Form 990 once the organization's gross receipts exceeded \$25 000.
- We also found that ten percent of the organizations use paid accounting help, and 26 percent had changed bookkeepers during the past year.

Conclusions

Based on the study of 300 randomly selected organizations coded as not required to file on the EO/BMF, we have concluded that the EO/BMF error rate is high - data errors were found in 51 percent of the records we studied.

INTRODUCTION

Background

During the June 1993 Ways and Means Oversight Subcommittee hearings on exempt organization matters, concerns were raised regarding the accuracy of data on the Exempt Organizations Business Master File (EO/BMF). Specifically, the Committee was concerned with the Service's procedures for capturing information on small organizations whose annual gross receipts are under the \$25,000 threshold for filing Form 990, Return of Organization Exempt from Income Tax. (Presently, approximately 555,000 entities, or half of the 1.1 million active entities on the EO/BMF, are coded as being nonfilers by reason of the \$25,000 gross receipts filing threshold.)

Since organizations with gross receipts under \$25,000 are not required to file information returns for tax years ending on or after December 31, 1982, the Committee questioned whether the Service's current procedures were effective in identifying organizations that had exceeded the filing requirement, or may have terminated, moved, or changed their name and address without proper notification to the Service.

In his testimony to the Committee, then Assistant Commissioner EP/EO John Burke stated that he felt a "discomfort" with the number of exempt organizations we have on our master file because it had not been "purified in terms of those organizations that might have gone out of existence. . ." Further, Mr Burke stated, "our follow-up program in terms of those that do not file with respect to having receipts less than \$25,000 is not good . . we put them on the master file and when they phase out of existence we do not have a strong effective follow-up program to purify the master file. . . nor do we have the resources at the present time to be able to do that kind of effective follow-up."

In November of 1993, a draft report prepared by the Andrew W. Mellon Foundation (the Foundation), and forwarded to EP/EO for comment, concluded that up to 40 percent of the small organizations on the EO/BMF may no longer be in existence. The Foundation, using an October 1991 EO/BMF extract of IRC 501(c)(3) entities purchased from the Service, created a database from which its analysis was performed. It discovered, in part, that "in the course of trying to determine exactly what a performing arts organization in New York City with less than \$25,000 in gross receipts could accomplish, that not only are the activities of some nonfilers very modest, but, more important, most nonfilers no longer give evidence of existing at all." The Foundation's findings on the non-existence of nonfilers were based on its attempt to locate 290 performing arts organizations with Manhattan zip codes. It concluded that it is "extremely difficult to find many of these organizations. . ." and "that the active portion of the BMF contains a number of organizations which are in fact inactive and that the overall size of the institutional population of nonprofits is thereby exaggerated considerably."

Exempt Organizations Nonfiler Team

As a result of the concerns raised in the hearings and the conclusions reached in the Mellon Foundation's report on the accuracy of the nonfiler Universe, Mr. Burke directed that a team be formed to determine the accuracy of the data on the EO/BMF for organizations coded as not required to file Form 990 returns. The team was charged with gathering, stratifying, and analyzing data on the not required to file population, determine whether there were inaccuracies, and if so, why those inaccuracies occur, and recommend solutions that would enhance future EO/BMF accuracy.

The team was formed in July 1993 and included employees from the former Offices of Field Compliance, Systems Development and Administration, the Exempt Organizations Technical Division, and the staff of the Assistant Commissioner (EP/EO).

FORM 990 FILING REQUIREMENTS

Historical Background for Current Law

Prior to its amendment by the Tax Reform Act of 1969, section 6033 of the Internal Revenue Code provided that an exempt organization must file annual information returns describing its gross income, expenses, disbursements, accumulations, balance sheets, and the total amount of contributions and gifts received during the year. This requirement applied only to exempt organizations other than religious organizations and certain of their affiliates, schools and colleges, publicly supported charitable organizations, certain fraternal beneficiary societies, and federally owned Congressionally chartered exempt organizations. However, by 1969, Congress was of the opinion that more information was needed, on a more current basis, from more organizations, and that the information must be made available to more people. As a result, section 6033 of the Code was substantially amended by the Tax Reform Act of 1969.

Although the legislative history of the 1969 Act indicates that Congress was concerned about the need for more complete information from exempt organizations, the new statute carved out several mandatory filing exceptions, and also gave the Treasury broad authority to create further discretionary exceptions.

Current Statutory Requirements

Section 6033(a)(1) of the Code requires the filing of annual information returns (Form 990, Return of Organization Exempt From Income Tax) by every organization exempt from taxation under section 501(a).

However, section 6033(a)(2)(A) of the Code provides certain mandatory exceptions to the filing requirement. The mandatory exceptions are: (i) churches, their integrated auxiliaries, and conventions or associations of churches; (ii) organizations (other than private foundations) described in 6033(a)(2)(C) and the gross receipts of which in each taxable year are normally not more than \$5,000; or (iii) the exclusively religious activities of any religious order. With respect to the \$5,000 gross receipts exception in (ii) above, section 6033(a)(2)(C) generally includes only organizations described in sections 501(c)(1), 501(c)(3), and 501(c)(8).

In addition, section 6033(a)(2)(13) of the Code provides for discretionary exceptions from filing information returns where the Secretary “determines that such filing is not necessary to the efficient administration of the internal revenue laws.”

Administrative Procedures and Actions

Section 1.6033-2(g)(6) of the Income Tax Regulations delegates the Secretary's authority under section 6033(a)(2)(13) of the Code to the Commissioner to excuse organizations from the filing requirement where it is determined that filing is not necessary to the efficient

administration of the internal revenue laws. The Commissioner may excuse organizations from filing Form 990 information returns by publishing an announcement in the Internal Revenue Bulletin, or by revising the instruction accompanying Form 990, amending the regulations, or other appropriate publication.

Section 1.6033-2(g)(1) of the regulations provides a partial list of organizations that are not required to file annual returns either because they are excepted by statute or because the Commissioner has exercised the authority referred to above. A more complete list is contained in Rev. Proc. 83-23, 1983-1 C.B. 687, which is supplemented by Rev. Proc. 86-23, 1986-1 C.B. 564 and Rev. Proc. 94-17, 1994-5 I.R.B. 24.

In general, the Commissioner will only exercise discretionary authority pursuant to section 1.6033-2(g)(6) of the regulations to relieve certain groups or types of organizations from the filing of information returns. One of the most prominent examples of the use of the Commissioner's discretionary authority is found in section 1.6033-2(g)(1)(iii) of the regulations. That provision excepts all exempt organizations (other than private foundations) from filing annual returns if their gross receipts in each taxable year are normally not more than \$5,000. This exception vastly expands the categories of organizations that are specifically excepted from the filing of returns pursuant to sections 6033(a)(2)(A)(ii) and 6033(a)(2)(C) of the Code, which were referenced above.

The \$5,000 gross receipts filing exception encompassed within section 1.6033-2(g)(1)(iii) of the regulations was only the first of several administrative actions that have been taken where the Commissioner exercised discretionary authority to relieve smaller exempt organizations (other than private foundations) from the filing of Form 990 information returns. Pursuant to Announcement 77-62, it was announced that exempt organizations (other than private foundations) that normally have gross receipts in each taxable year of not more than \$10,000 were not required to file Form 990 returns for tax years ending on or after December 31, 1976. Then, in Announcement 82-88, the floor for the filing exception was raised from \$10,000 of gross receipts to \$25,000 for tax years ending on or after December 31, 1982.

The raising of filing threshold for Form 990 information returns from \$5,000 to \$10,000 in 1977, and then from \$10,000 to \$25,000 in 1982, was intended to reduce the administrative burden of the Service, and also to reduce unnecessary paperwork. The Service was annually expending a considerable number of staff hours assessing and attempting to collect penalties from organizations with limited resources for their failure to file the required information return, and generally little use was made of the information when it was received. The changes in the filing threshold were also deemed consistent with efforts to reduce unnecessary paperwork for small organizations, many of which are run by volunteers chosen to hold office for a short term (e.g., one year), and who typically lack sophistication in tax matters. Another consideration in the decisions to raise the filing threshold was the fact that many organizations were falling within the Form 990 filing requirement solely because of the effects of inflation and the passage of time, and not because of any increase in membership numbers or expansion of their activities.

THE SURVEY

Survey Methodology

A. Determining the sample

The population to be surveyed was the approximately 550,000 organizations coded on the EO/BMF with filing requirement 2. Such filing requirement code indicates that the organization's gross receipts are normally less than \$25,000 per year, and therefore no Form 990 return is required.

It was determined that a sample of 90 organizations would be required to achieve a 95 percent confidence interval, with an approximate margin of error of ten percent. Although a sample of 90 organizations was considered by the team, after lengthy discussion it was concluded that certain profiles could not be adequately developed with a sample of only 90 organizations, because we desired to profile groups within the sample. For example, we believed that the comparison of section 501(c)(3) organizations versus all other organizations, and comparing organizations with individual rulings versus organizations part of a group ruling could provide useful information regarding the compliance levels of particular types of organizations. Therefore, we decided to use a sample of sufficient size so that contemplated subsamples would produce a sample of 90 cases with an approximate margin of error of ten percent.

Based on the subsample categories chosen, we determined that the percentage of section 501(c)(3) organizations in the total sample would dictate the sample size necessary to achieve the desired margin of error. Given that section 501(c)(3) organizations made up 33 percent of the total population, we concluded that the sample would have to include 270 organizations. We then decided to include an even 300 organizations in our sample.

The sample of 300 organizations was obtained from EO/BMF microfiche using the *sample.exe* program. We found that the selected sample matched the general breakdown of the overall population.

B. Defining the Task

The first thing the team wanted to determine was whether there was compliance. Were organizations coded as not required to file on the EO/BMF complying with the law? Therefore, because an organization's gross receipts determines whether it is required to file a Form 990 return, we devised a financial questionnaire that would allow us to make an objective determination whether the organization was, in fact, not required to file a Form 990 return.

We also included questions in the questionnaire which were designed to tell us the level of knowledge of the person in the organization who was charged with making the Form 990 filing decision. We asked whether such a person was aware of the filing requirement, whether that person had changed in the last year, and whether professional help was obtained in

maintaining the organization's books and records.

As we developed the questionnaire we were well aware of the Mellon Foundation's study, and its conclusion that a high percentage of organizations were no longer at the address listed on the EO/BMF. Therefore, we decided that it would be important for us to know how many of the questionnaires were returned undeliverable, and how many nonresponders were no longer in existence. Accordingly, we asked that the field offices mail out the questionnaire to each of the organizations and record the undeliverables and nonresponders, the follow-up action taken with respect to each, and the outcome of the follow up action (i.e., was the organization found to be in existence or was it no longer in existence).

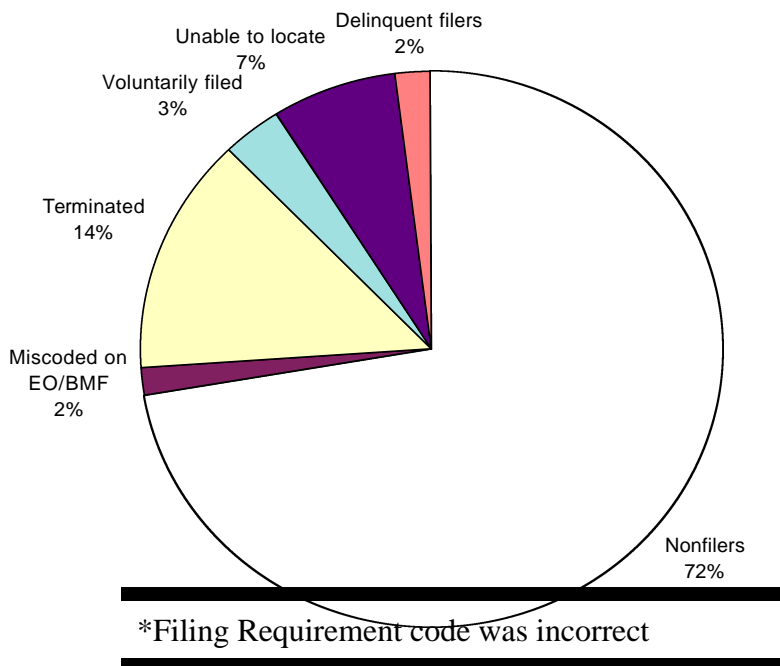
Findings

As indicated in the chart to the right, the team found that 72 percent of the organizations selected for the study continue to be active and are properly classified as not required to file (i.e., nonfilers) on the EO/BMF. The team also found that nearly fourteen percent of the organizations in the study had terminated their activities, and another seven percent could not be located by our agents even though exhaustive searches were conducted. In addition, the OCEP

exam results indicated that about three percent of the organizations in the study became required to file returns during the course of the study (i.e., their gross receipts went over the \$25,000 filing threshold) and voluntarily filed Form 990 prior to being contacted by the Service; and two percent of the organizations in the study were liable for filing Form 990 returns, but did not do so (delinquent filers).

The team found that five of the organizations selected as part of the study had been miscoded on the EO/BMF - two of the organizations were churches (there is a separate code on the EO/BMF to indicate nonfiling status for a church), and three were IRC 501(c)(14) state

Results of Study of 300 Organizations Classified as "Nonfilers" on the EO/BMF



chartered credit unions (such organizations exceed the \$25,000 filing threshold, but are generally coded as not required to file because we know the state files a consolidated return for such organizations). In addition, other EO/BMF inaccuracies were revealed in the study. Using the agents' work papers, we determined that 33 percent of the organizations actually located had EO/BMF data errors other than their filing status (e.g., address, name, EIN, etc.), and multiple errors were found in six percent of the cases.

The questionnaire that we required the field agents to complete as part of the OCEP exams contained questions that enabled the team to gain some insight into the operation of the organizations. The information secured from the organizations that were actually located indicates that in about 24 percent of the cases the persons responsible for maintaining the organization's books and records were unaware of their obligation to file Form 9905 once the organization's receipts exceeded \$25,000. We also learned that ten percent of the organizations use paid accounting help, and that 26 percent had changed bookkeepers during the past year.

Conclusions

A. Results with respect to organizations part of a group ruling

The study indicates the possibility that the Supplemental Group Ruling Information (SGU) required by Rev. Proc. 80-27 is not being properly handled by the service center Entity Control Units. Subordinate organizations in the survey that had terminated or could not be located should have been identified by the SGRI process. On the other hand, it is also possible that central organizations are failing to provide the information required under Rev. Proc. 80-27.

B. CP 140 Notice program

Issuance of a CP 140 Notice every three years to verify continued nonfiler status appears to be too long of a time frame. The survey indicated that 21 percent of all organizations had either terminated or could not be located. Also, having no follow-up procedure to nonresponders to the CP 140 Notice contributes to the high percentage of inactive accounts

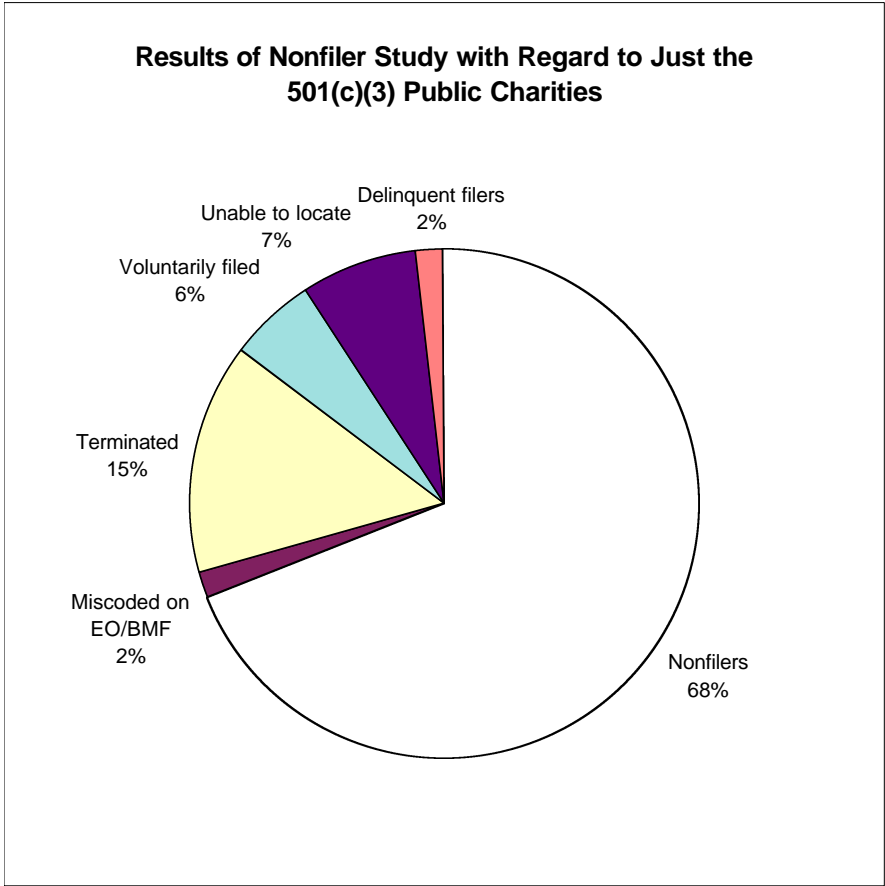
C. Compliance

Of the 238 organizations in the survey that were found to still be active, 97 percent were correctly not filing Form 990s.

<u>E.O. NONFILER STUDY</u> <u>SIGNIFICANT STATISTICS</u>	
1. Percent of all organizations examined that had either terminated or could not be located:	21%
2. Percent of all IRC 501(c)(3) charities examined that had either terminated or could not be located:	22%
3. Percent of organizations actually located whose gross receipts exceed the \$25,000 filing threshold (should have filed Form 990):	2%
4. Percent of organizations actually located that become required to file Form 990 and did not file:	4%
5. Percent of organizations actually located that filed Form 990 even though gross receipts were below the \$25,000 filing threshold:	11%
6. Percent of organizations actually located that use paid help to keep their books and records:	10%
7. Percent of organizations actually located whose bookkeeper changed during the past year:	26%
8. Percent of all organizations in the study that had one or more EO/BMF errors (incorrect filing status, name, address, EIN, etc.):	51%
9. Percent of organizations actually located that had an error other than filing status on the EO/BMF (address, name, EIN, etc.):	33%
10. Percent of organizations actually located whose address was incorrect on the EO/BMF:	27%
11. Percent of organizations located whose EO/BMF accounts had errors other than filing status or address (name, EIN, etc.):	13%

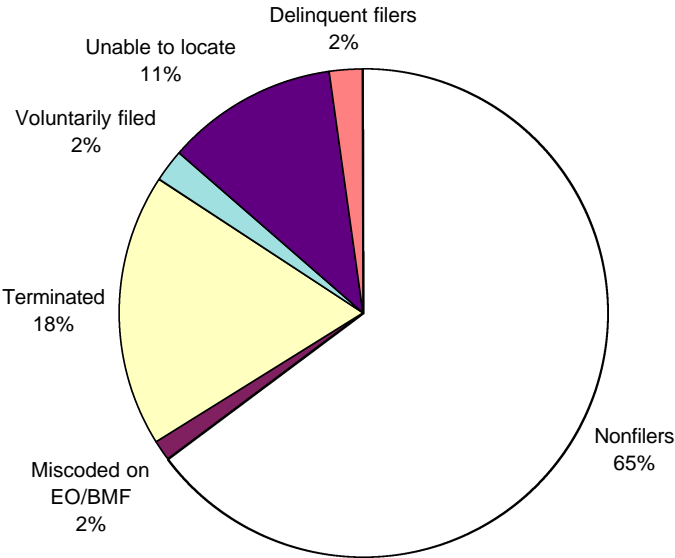
ADDITIONAL CHARTS

(For particular types of organizations)



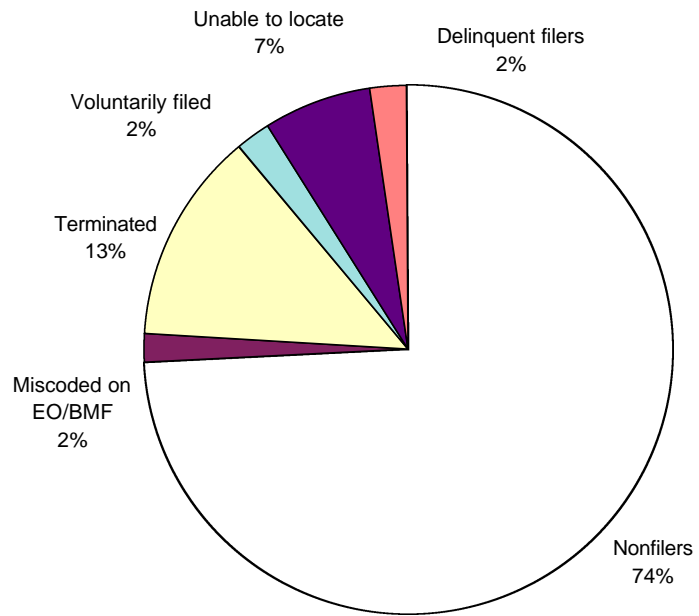
(Total of 109 organizations)

**Results of Nonfiler Study with Regard to
Organizations with Individual Rulings**



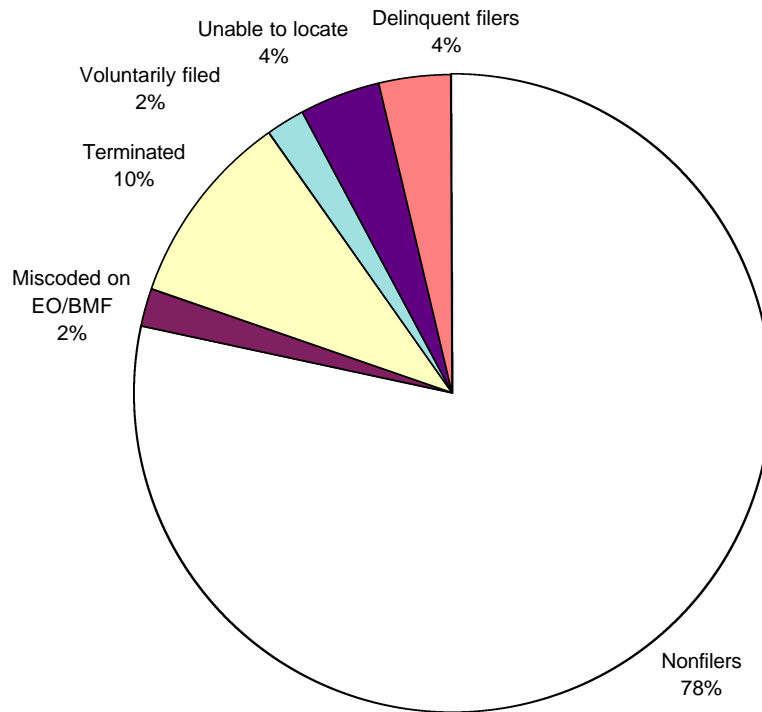
(Total of 133 organizations)

Results of Nonfiler Study with Regard to All Non-501(c)(3) Organizations



(Total of 191 organizations)

Results of Nonfiler Study with Regard to Organizations Part of a Group Ruling



(Total of 167 organizations)

Attachment

NONFILER TEAM RECOMMENDATIONS

The team proposes the following three-point approach to improve the accuracy of the information on the EO/BMF regarding the approximately 555,000 organizations coded as not required to file Form 990.

1. We propose a one-time mailout of questionnaires to the approximately 230,000 organizations that have individual rulings (not part of a group ruling), to be undertaken during FY 1995. The purpose of the mailout will be to determine the continued existence of the organizations; the accuracy of the filing status, address, and other entity information; and to educate organizations regarding filing requirements. Responses to questionnaires will be reviewed by a team of Taxpayer Service and EP/EO employees who will conduct follow-up activities, update and correct files, and compile statistics.

2. We propose the present service center CP 140 notice program (contacting individual nonfiler entities once every three years to verify their continued nonfiler status) be modified to address and resolve undeliverables and non-respondents.

3. We propose Headquarters analysts begin an on-going review and follow-up on service center Entity Control Unit procedures for processing corrections to subordinate unit entities included in group rulings. Such changes are submitted to centers on a yearly basis by parent organizations via their yearly Supplemental Group Ruling Information required by Rev. Proc. 80-27.