



*Review of the Processing of Referrals  
Alleging Impermissible Political Activity  
by Tax-Exempt Organizations*

**October 4, 2018**

**Reference Number: 2019-10-006**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

1 = Tax Return/Return Information

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## HIGHLIGHTS

### REVIEW OF THE PROCESSING OF REFERRALS ALLEGING IMPERMISSIBLE POLITICAL ACTIVITY BY TAX-EXEMPT ORGANIZATIONS

## Highlights

**Final Report issued on October 4, 2018**

Highlights of Reference Number: 2019-10-006  
to the Commissioner of Internal Revenue.

### IMPACT ON TAXPAYERS

The IRS receives and reviews referrals (complaints) from citizens, Members of Congress, and IRS employees alleging that tax-exempt organizations are engaged in improper conduct. To promote public trust in tax administration, referrals should be reviewed impartially to determine whether examinations are warranted.

### WHY TIGTA DID THE AUDIT

A U.S. Senate Committee on Finance (Committee) bipartisan investigation concluded that the IRS had not performed any examinations of 501(c)(4) tax-exempt groups based on referrals alleging impermissible political activity from 2010 to 2014. In addition, an internal IRS review concluded that the prior IRS process potentially gave the impression that somehow the political leanings of organizations were considered when evaluating referrals. The Committee recommended that TIGTA review the IRS's revised procedures and whether referrals have resulted in examinations.

### WHAT TIGTA FOUND

In July 2015, the IRS created the Political Activities Referral Committee (PARC) with three experienced managers to independently review referrals containing allegations of impermissible political activity and determine if examinations were warranted. Between July 2015 and August 2016, 19 high-profile referrals were forwarded to the PARC. The PARC evaluated the 19 referrals and recommended 10 examinations, more than one-half of which involved 501(c)(4) tax-exempt

groups. As of January 2018, five of the 10 recommended examinations had not been initiated; \*\*\*\*\*1\*\*\*\*\*

\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*

As of January 2018, there have been no revocations or other negative findings as a result of examinations.

TIGTA determined the IRS did not adequately document research related to the allegation, tax-exempt laws evaluated, or the rationale behind decisions made. This documentation is vital because the referrals are high profile, involve extremely sensitive allegations of impermissible political activity, and require a subjective analysis of often unique facts and circumstances of unverified information from the allegations.

Further, TIGTA reviewed a statistical sample of referrals from more than 6,500 referrals concerning tax-exempt organizations received by the IRS between July 2015 and August 2016. Based on this review, TIGTA estimates that more than 1,000 referrals related to allegations of impermissible political activity were not forwarded to the PARC. While the sampled referrals were generally not as high profile as the 19 reviewed by the PARC, they did meet IRS criteria for forwarding to the PARC.

### WHAT TIGTA RECOMMENDED

TIGTA made five recommendations to the Acting Commissioner, Tax Exempt and Government Entities Division, such as providing further guidance and training on the requirements for consistently and clearly documenting referral case files, and requirements for forwarding cases to the PARC.

In their response to our report, IRS management agreed with all five recommendations. The IRS stated that it has emphasized the requirements for consistently documenting related research for cases, and provided guidance and group discussions on forwarding cases to the PARC.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

October 4, 2018

**MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE**

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Review of the Processing of Referrals Alleging  
Impermissible Political Activity by Tax-Exempt Organizations  
(Audit # 201610025)

This report presents the result of our review to assess the Internal Revenue Service's (IRS) efforts to evaluate allegations of impermissible political activity by tax-exempt organizations. A U.S. Senate Committee on Finance bipartisan investigation concluded that "...from the end of 2010 until April 2014, the IRS did not perform any examinations of 501(c)(4) organizations related to impermissible political campaign intervention." In addition, an internal IRS review concluded that the prior IRS process "...arguably gave the impression that somehow the political leanings of the organizations mentioned were considered in making the ultimate decision of whether or not to recommend an examination or compliance check." The U.S. Senate Committee on Finance recommended that we review the IRS's revised procedures and whether referrals have resulted in examinations. This review is included in our Fiscal Year 2018 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

Management's complete response to the draft report is included as Appendix VII. We have concerns about the accuracy of certain statements in the IRS's response to our report. We have noted these concerns in Appendix VIII.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Troy D. Paterson, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations).



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Political Activity by Tax-Exempt Organizations*

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*Abbreviations*

|        |   |
|--------|---|
| EO     | Exempt Organizations                        |
| I.R.C. | Internal Revenue Code                       |
| IRM    | Internal Revenue Manual                     |
| IRS    | Internal Revenue Service                    |
| PARC   | Political Activities Referral Committee     |
| RCCMS  | Reporting Compliance Case Management System |
| TE/GE  | Tax Exempt and Government Entities          |



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## *Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations*

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### *Background*

Between July 2015 and August 2016, the Internal Revenue Service (IRS) received more than 6,500 complaints (hereafter referred to as referrals) concerning tax-exempt organizations. These referrals include allegations that tax-exempt organizations were potentially noncompliant with the tax law, noncompliant with the tax-exempt purpose of the organization, or participating in impermissible political activity.

***Between July 2015 and August 2016, the IRS received more than 6,500 referrals (complaints) concerning tax-exempt organizations.***

The Tax Exempt and Government Entities (TE/GE) Division is responsible for receiving and assessing these referrals, which it receives from the general public, Members of Congress, Federal and State agencies, as well as other parts of the IRS. According to the Internal Revenue Manual (IRM),<sup>1</sup> when reviewing referrals, TE/GE Division personnel are required to follow special procedures designed to ensure that the IRS operates in an unbiased and appropriate manner, and that its compliance programs are protected against undue influence by outside intervention.<sup>2</sup>

At the time of our review, all referrals were centrally processed in the Exempt Organizations (EO) function Classification Unit<sup>3</sup> in Dallas, Texas, and tracked on the Reporting Compliance Case Management System (RCCMS).<sup>4</sup> Experienced EO function Classification Unit employees (hereafter referred to as classifiers) review the referrals and conduct appropriate research to evaluate the facts and determine whether or not an examination is warranted. Referrals containing evidence or allegations of political or lobbying activities were required to be sent to the Political Activities Referral Committee (PARC).

The PARC is composed of three members selected at random from a pool of all EO function Examinations and Rulings and Agreements front-line managers. Each member receives political activity training and serves on the PARC for 24 months. The PARC's responsibility is to consider the examination potential of referrals in a fair and impartial

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<sup>1</sup> The primary official source of IRS instructions to staff related to the organization, administration, and operation of the IRS. It details the policies, delegations of authorities, procedures, instructions, and guidelines for daily operations for all divisions and functions of the IRS.

<sup>2</sup> IRM 4.75.5.1(1) (Aug. 19, 2016).

<sup>3</sup> The TE/GE Division reorganized in April 2017. As a result, the EO function Classification Unit was moved from the EO function to the Government Entities/Shared Services function and renamed the EO Referral Group.

<sup>4</sup> The RCCMS provides TE/GE Division personnel with the capability to perform operating division-wide inventory control, compliance testing, quality measurement, tax computing, education and outreach, and team examination monitoring.



## *Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations*

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manner, and PARC members are expected to use their experience, judgment, and concern for fairness in making this determination. Each PARC member independently reviews all information pertaining to the referral and determines examination potential based on whether the information establishes a “reasonable belief”<sup>5</sup> that warrants further action by the EO function’s Examinations program. Before a referral is sent to the Examinations program, there must be a majority vote in which two out of the three PARC members determine that an examination is warranted.

### **Impermissible political activity of tax-exempt organizations**

Impermissible political activity may include political campaign intervention, influencing legislation, or other advocacy depending on the type of organization and how often the activities are conducted. Political campaign intervention includes any and all activities that favor or oppose one or more candidates for public office. Influencing legislation, also known as lobbying, involves proposing, supporting, or opposing legislation. Examples of other advocacy include attempting to influence public opinion on issues germane to the organization’s tax-exempt purpose, influencing nonlegislative governing bodies, or encouraging voter participation in a nonpartisan, neutral manner.

The Internal Revenue Code (I.R.C.) section and subsection under which an organization is granted tax exemption affects the activities it may undertake. For example, I.R.C. Section (§) 501(c)(3) charitable organizations are prohibited from directly or indirectly participating in or intervening in any political campaign on behalf of, or in opposition to, any candidate for public office.<sup>6</sup> However, I.R.C. § 501(c)(4) social welfare organizations, I.R.C. § 501(c)(5)<sup>7</sup> agricultural and labor organizations, and I.R.C. § 501(c)(6)<sup>8</sup> business leagues may engage in limited political campaign intervention. Figure 1 highlights certain restrictions on the activities of common types of tax-exempt organizations.

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<sup>5</sup> To meet the “reasonable belief” standard, the information needs to show a violation of tax laws may have occurred and appear likely to lead to the discovery of a violation of tax laws upon examination.

<sup>6</sup> Political campaign intervention is the term used in Treasury Regulations §§ 1.501(c)(3)-1, 1.501(c)(4)-1, 1.501(c)(5)-1, and 1.501(c)(6)-1.

<sup>7</sup> I.R.C. § 501(c)(5) (2012).

<sup>8</sup> I.R.C. § 501(c)(6) (2012).





## Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations

**Figure 1: Restrictions on the Activities of  
Common Types of Tax-Exempt Organizations**

| Restriction   | I.R.C. § 501(c)(3)                         | I.R.C. §§ 501(c)(4),<br>(c)(5), and (c)(6)                      |
|---|--|---|
| May engage in political campaign intervention   | No   | Limited (must not constitute primary activity of organization)  |
| May engage in lobbying, <sup>9</sup> <i>i.e.</i> , legislative activity                               | Limited (must not be substantial)          | Yes (unlimited amount, if in furtherance of tax-exempt purpose) |
| May engage in general advocacy <sup>10</sup> not related to legislation or the election of candidates | Yes (permitted as an educational activity) | Yes (unlimited amount, if in furtherance of tax-exempt purpose) |

Source: Various IRM sections.

### **Senate Committee on Finance audit request**

As part of its investigation into the IRS’s handling of applications for tax-exempt status submitted by political advocacy organizations, the U.S. Senate Committee on Finance reported<sup>11</sup> that “...from the end of 2010 until April 2014, the IRS did not perform any examinations of 501(c)(4) organizations related to impermissible political campaign intervention.” During that time, the IRS tried to implement a new process, referred to as the Dual Track process,<sup>12</sup> to assess allegations of political campaign intervention by tax-exempt organizations. However, internal IRS review of the process “...arguably gave the impression that somehow the political leanings of the organizations mentioned were considered in making the ultimate decision of whether or not to recommend an examination or compliance check.”

<sup>9</sup> An organization engages in lobbying or legislative activities when it attempts to influence specific legislation by directly contacting members of a legislative body (Federal, State, or local) or encouraging the public to contact those members regarding that legislation. An organization also engages in lobbying when it encourages the public to take a position on a referendum. Lobbying is distinguished from political campaign intervention because lobbying does not involve attempts to influence the election of candidates for public office.

<sup>10</sup> An organization engages in general advocacy when it attempts to 1) influence public opinion on issues germane to the organization’s tax-exempt purposes, 2) influence nonlegislative governing bodies, *e.g.*, the executive branch or regulatory agencies, or 3) encourage voter participation through “get out the vote” drives, voter guides, and candidate debates in a nonpartisan, neutral manner. General advocacy basically includes all types of advocacy other than political campaign intervention and lobbying.

<sup>11</sup> Senate Committee on Finance, *The Internal Revenue Service’s Processing of 501(C)(3) and 501(C)(4) Applications For Tax-Exempt Status Submitted By “Political Advocacy” Organizations From 2010-2013* (Aug. 2015).

<sup>12</sup> Dual Track refers to the process in which both the referral information and data analytics were used to assess allegations of political campaign intervention by tax-exempt organizations.



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The Dual Track process was suspended in June 2013 and permanently discontinued in Calendar Year 2015. Since the Dual Track process was discontinued, the IRS has sent referrals alleging impermissible political campaign intervention to the PARC.

In its report, the U.S. Senate Committee on Finance recommended that the Treasury Inspector General for Tax Administration review the recently enacted EO function procedures to determine if 1) the process enables the IRS to impartially evaluate allegations of impermissible political activity, 2) any of the referrals have resulted in the IRS opening an examination related to political activity, and if so, whether such an examination was warranted, and 3) the IRS should make further modifications to ensure that it carries out the enforcement function in a fair and impartial manner.

This review was performed at the EO function's Classification Unit office in Dallas, Texas, during the period August 2016 through February 2018, and involved reviewing cases forwarded to the PARC during the period of July 2015 through August 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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*Results of Review*

**The Tax Exempt and Government Entities Division Developed a New  
Process for Evaluating Referrals Alleging Impermissible Political  
Activity**

In July 2015, the IRS created the PARC with three experienced managers to independently review referrals containing allegations of impermissible political activity and determine if examinations were warranted. The IRS notes in its IRM that these new processes were designed to ensure that the IRS operates in an unbiased and appropriate manner.<sup>13</sup>

We reviewed case documentation for all 19 referrals<sup>14</sup> sent to the PARC between July 2015 and August 2016, and found that all 19 referrals were independently reviewed and the final decision on whether or not to examine was based on a majority vote. While procedures do not limit how many referrals involving allegations of impermissible political activity should be subject to this procedure, only a small number of high-profile referrals were actually forwarded to the PARC. This issue is discussed in more detail later in this report.<sup>15</sup> In addition, we determined that

initially \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*

Lastly, we reviewed case documentation explaining each PARC members' rationale for determining whether or not to recommend the referrals for examination. We found that PARC members' documentation did not mention the political leanings of the organizations when making their determinations.

Having multiple individuals review referrals involving allegations of impermissible political activity and acting on a majority vote reduces the risk of political bias. However, it is important to have procedures for instances when there is not a majority vote so the IRS can ensure that decisions are not swayed by another board member's decision.

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<sup>13</sup> IRM 4.75.5.1(1) (Aug. 19, 2016).

<sup>14</sup> Only 14 of the referrals involved allegations of impermissible political activities. The remaining five referrals were submitted by Members of Congress or involved other high-impact issues. Although not all 19 of the referrals contained allegations of impermissible political activities, we determined that all 19 referrals were high profile and involved extremely sensitive allegations.

<sup>15</sup> See the section in this report entitled *Most Allegations of Political Campaign Intervention or Lobbying Were Not Forwarded to the Political Activities Referral Committee for Review As Required*.



## Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations

During the period of July 2015 through August 2016, \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*.<sup>16</sup> PARC members recommended  
examinations for 10 of the \*1\* remaining referrals based on a majority vote. Figure 2 shows the  
status of the remaining \*1\* referrals as of January 2018.

**Figure 2: Status of Referrals Forwarded to the PARC  
Between July 2015 and August 2016**

| Status as of January 2018                                  | Number of<br>§ 501(c)(3)<br>Cases | Number of<br>§ 501(c)(4)<br>Cases |
|--|-----------------------------------|-----------------------------------|
| PARC Did Not Recommend Referral<br>for Examination         | *1*                               | 0                                 |
| PARC Recommended Referral for<br>Examination               | 4                                 | 6                                 |
| Examination Completed – No<br>Compliance Issues Identified | *1*                               | *1*                               |
| Examination Ongoing  | 0                                 | *1*                               |
| EO Function Decided Not to<br>Perform Examination          | 0                                 | *1*                               |
| Awaiting Examination                                       | *1*                               | *1*                               |

Source: Treasury Inspector General for Tax Administration case reviews.

### Recommendation

**Recommendation 1:** The Acting Commissioner, TE/GE Division, should update procedures to address situations when a PARC majority vote is not reached independently.

**Management's Response:** The IRS agreed with the recommendation. The IRS stated that, in the course of routine updates to its procedures, the TE/GE Division had already updated IRM 4.75.5 to address situations when a PARC majority vote is not reached independently. More specifically, the IRS stated that the IRM was updated and published on August 19, 2016, stating the following, "Two out of three PARC members must make a forwarding recommendation (majority rule) for the referral to be forwarded to an EO Examination group." In addition, the IRS stated that the applicable desk guide provides, "Two of the three members of the PARC must agree on the determination of whether an examination is warranted or not (majority rule)," and it further clarifies, "If

<sup>16</sup> \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*



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two members do not agree that the case should be examined, it will not be selected for examination.”

**Office of Audit Comment:** We do not believe that the IRS’s corrective actions are adequate. The IRS responded that its desk guide was updated to state that two of three PARC members must agree on whether an examination is warranted. This would be adequate if the only two options PARC members had were to recommend an examination or not. Instead, PARC members have up to six different recommendations they can make after reviewing a referral. Our audit work determined that initially \*1\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\* As such, we continue to believe more clarity is needed to address situations when a majority vote is not reached independently.

### **A More Consistent and Comprehensive Process Is Needed for Evaluating Referrals Alleging Impermissible Political Activity**

While the TE/GE Division has made progress in evaluating high-profile referrals alleging impermissible political activity, the TE/GE Division did not ensure that all referrals forwarded to the PARC included thorough and complete case file documentation. We determined that 1) classifier documentation of research related to the allegation was not always consistent or complete and 2) PARC members did not adequately document research, tax-exempt laws evaluated, or the rationale behind decisions made. This documentation is vital because the referrals are high profile, involve extremely sensitive allegations of impermissible political activity, and require a subjective analysis of often unique facts and circumstances of unverified information from the allegations.

#### **Classifier documentation was not always consistent or complete**

Classifier case files for each of the 19 referrals sent to the PARC did not always include required documentation. We reviewed each of the 19 case files and found that, while some classifiers included all of the required documentation and research items, others did not. IRM guidelines<sup>17</sup> state that classifiers are to prepare case files prior to submitting a referral to the PARC, including internal research on IRS systems, Internet research, and a completed Classifications Lead Sheet.<sup>18</sup> A completed Classifications Lead Sheet should include the following elements: the referral issues, relevant facts, associated tax law, and the classifier’s conclusion. All of the case files included a Classifications Lead Sheet. Several of the Lead Sheets we reviewed were

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<sup>17</sup> IRM 4.75.5.5(5) (Aug. 19, 2016).

<sup>18</sup> Appendix V includes the template for a Classifications Lead Sheet, which shows what information is required to be included.



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thorough; however, 13 (68 percent) of 19 Classifications Lead Sheets did not include all of the required elements. For example, several Lead Sheets included a short paragraph summarizing the issues received in the referral, but did not include any specific analysis of the associated tax law.<sup>19</sup> As a result, it was difficult to determine the research performed by classifiers in some cases.

It is important for classifiers to document the research performed for allegations forwarded to the PARC because PARC members use this information and their own research and judgment to determine whether or not to recommend a referral for examination. During our interviews with EO function Classification Unit staff, we found that some classifiers were not familiar with the criteria outlined in the IRM regarding the required elements to be included on Classifications Lead Sheets. For example, one classifier stated that the case file should include internal research, Internet research, and a Classifications Lead Sheet summarizing only the facts from the referral. Another classifier stated that he or she did not receive formal training on classification procedures and requirements.

### **PARC documentation was not always adequate**

PARC members did not always adequately document their review of referrals. We reviewed the documentation prepared by each PARC member for all 19 referrals sent to the PARC between July 2015 and August 2016. In all of the 19 cases, we found one or more of the PARC members did not clearly document what research had been performed, the tax-exempt laws evaluated, or the rationale behind their decision on whether or not to recommend the referral for examination. For example, the complete documentation entered by the PARC members into the RCCMS sometimes consisted of only a few words. Figure 3 shows examples of inadequate PARC member documentation concerning referrals about § 501(c)(4) organizations. As noted previously, § 501(c)(4) organizations can intervene in political campaigns, as long as it is not the organization's primary activity.

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<sup>19</sup> See Figures 1 and 2 in Appendix VI for a comparison of a Classifications Lead Sheet that is more thorough and a Classifications Lead Sheet that does not include all required elements.



## Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations

**Figure 3: Examples of PARC Member Rationale  
for Selecting or Not Selecting a  
§ 501(c)(4) Organization for Examination**

|               |
|---------------|
| *****1*****   |
| *****1*****   |
| *****1*****20 |
| *****1*****   |

Source: Verbatim examples of PARC member documentation taken from the RCCMS database for the 19 referrals reviewed by the PARC (errors in the original).

According to an IRS memorandum issued on July 17, 2015, the PARC must identify and document activities, associated tax laws, and conclusions for evaluating referrals. If the PARC does not provide adequate documentation, then it is difficult to determine what research was conducted and what was considered in making a decision on whether an examination was warranted. Further, when referrals lack adequate PARC member documentation, it also becomes difficult to determine whether a referral was impartially evaluated.

During our interviews with PARC members, we found that PARC members were unaware of the requirement to document their activities performed and associated tax laws evaluated in reviewing referrals and making a determination. In addition, managerial reviews did not ensure that PARC documentation requirements were met before the referrals were closed or forwarded to the EO function's Examinations program.

### Recommendations

The Acting Commissioner, TE/GE Division, should:

**Recommendation 2:** Train classifier personnel on the requirements for consistently documenting related research for cases forwarded to the PARC.

**Management's Response:** The IRS agreed with the recommendation. The IRS stated that it regularly trains classifier personnel. In training held in April 2018, the IRS emphasized the requirements for consistently documenting related research in the RCCMS for cases forwarded to the PARC.

20 \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*.





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**Recommendation 3:** Provide further guidance and training for PARC members to ensure that the rationale for determining whether an examination is warranted is clearly documented.

**Management's Response:** The IRS agreed with the recommendation. The IRS stated that new PARC members rotated and were trained in the normal course of business in June 2017. The training for new PARC members included discussions on how to use the RCCMS for reviews and to ensure that the rationale for determining whether an examination is warranted is clearly documented. Additionally, the IRS stated that the Referrals Manager provided one-on-one training for each PARC member on types of documentation to be included in the RCCMS.

**Recommendation 4:** Quality review a sample of cases forwarded to the PARC to provide reasonable assurance that documentation requirements are met.

**Management's Response:** The IRS agreed with the recommendation. The IRS stated that in the normal course of business, the Referrals Manager conducts periodic quality checks on all referrals, including potential PARC referrals. The last such review was completed in July 2017.

**Office of Audit Comment:** We do not believe that the IRS's corrective actions are adequate. While the IRS stated that it conducts quality checks on all referrals in the normal course of business, we found that one or more of the PARC members did not clearly document what research had been performed, the tax-exempt laws evaluated, or the rationale behind their decision on whether or not to recommend the referral for examination in all 19 PARC cases we reviewed.

### **Most Allegations of Political Campaign Intervention or Lobbying Were Not Forwarded to the Political Activities Referral Committee for Review As Required**

We reviewed a statistical sample<sup>21</sup> of referrals from more than 6,500 referrals received by the EO function Classification Unit between July 2015 and August 2016, and determined a significant number of allegations involving impermissible political activity were not forwarded to the PARC as required.

During the period of July 17, 2015, through August 17, 2016, the EO function Classification Unit received 6,539 referrals that were entered into the RCCMS. We selected a statistically valid sample of 95 out of the 6,539 referrals to determine if they contained allegations of political campaign intervention or lobbying, and if so, whether or not they were sent to the PARC. Our review identified that 11 (12 percent) of the 95 referrals involved allegations of impermissible political activity by tax-exempt organizations and met IRM criteria to be forwarded for review

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<sup>21</sup> See Appendix I for details on our sampling methodology.





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by the PARC. However, none of the 11 referrals were forwarded to the PARC as required. Further analysis determined that all 11 referrals were closed as not recommended for examination by the classifier. Based on the results of our sample, we estimate that more than 1,000 referrals<sup>22</sup> with allegations of political campaign intervention or lobbying were not forwarded to the PARC for review. While the sampled referrals were generally not as high profile as the 19 referrals reviewed by the PARC, IRM guidelines<sup>23</sup> state that referrals containing evidence or allegations of political or lobbying activities should be forwarded to the PARC.

During our interviews, we found that some classifiers were not familiar with the IRM criteria. In addition, some classifiers used factors such as source of the referral, the amount of documented support included with the referral, sensitivity, or the type of tax-exempt organization to determine if the referral warranted review by the PARC. Not following IRM guidelines circumvents an important process that exists to reduce the risk of bias and ensure that cases are properly considered for referral to the Examinations program. Further, we found inconsistencies between procedures outlined in the IRM and the desk guide procedures used by classifiers.

Based on a draft version of our report, IRS officials stated that they believed guidance in the IRM and associated desk guide needs to be revised to clearly reflect that classifiers have discretion in determining whether to send a referral to the PARC. IRS officials also stated that it was never their intent to forward all referrals with allegations of impermissible political activity to the PARC. During our review, EO function Classification Unit management stated that if all referrals alleging political activity or lobbying were sent to the PARC, then PARC members would be overwhelmed and unable to review them all. While it is likely that additional guidance and criteria could help to manage the number of referrals sent to the PARC, we believe there should be limits on the use of discretion in this area given the potential that bias could enter into decisions of whether or not to refer these types of cases for examination. One of the main benefits of the PARC is to help mitigate the potential for such bias.

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<sup>22</sup> The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 455 and 1,566. See Appendix IV.

<sup>23</sup> The IRM dated August 7, 2013, states that information items (referrals) should be referred to the EO Referral Committee if they contain evidence or allegations of political or lobbying activities. In July and December of 2015, the IRS issued interim guidance memoranda clarifying the composition and operations of the PARC and changing all references in the IRM from “EO Referral Committee” to “the PARC.” This guidance also stated that the EO Referrals Group would refer information items containing evidence or allegations of political or lobbying activities to the PARC. This same language was later used in the revised IRM dated August 19, 2016.



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## *Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations*

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### **Recommendation**

**Recommendation 5:** The Acting Commissioner, Tax Exempt and Government Entities, should clarify guidance for consistency and train personnel on the requirements for transferring cases to the PARC.

**Management's Response:** The IRS agreed with the recommendation. The IRS stated that all EO function Examination classifiers received the updated Referrals Desk Guide in February 2017, which provided detailed processes and procedures related to referrals, including for referrals related to political campaign intervention. Guidance and group discussions were provided to senior classifiers on transferring cases to the PARC. The IRS also stated that it is the responsibility of the group manager to notify the PARC and to ensure that PARC members have access to the case and ultimately review it. Additionally, each PARC member received formalized training and understands how a case comes to them, how they review the case, and how the case is returned back to the Referrals Manager.

**Office of Audit Comment:** We do not believe that the IRS's corrective actions are adequate. While the IRS responded that it updated its processes and procedures, the updated IRM and the desk guide continue to state that referrals with evidence or allegations of impermissible political activity are forwarded to the PARC.<sup>24</sup> However, in its memorandum accompanying the response, the IRS stated that it must forward to the PARC only those referrals that are procedurally sufficient.<sup>25</sup> Our concern is that the procedures do not clearly define instances when referrals should not go to the PARC, nor state that this should only happen in limited instances. As a result, the IRS is providing the classifiers with the discretion to not forward certain referrals with evidence or allegations of impermissible political activity to the PARC. This circumvents an important process that exists to reduce the risk of bias and ensure that cases are properly considered for referral to examination.

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<sup>24</sup> As of July 2018, the current IRM continues to state that the IRS forwards referrals containing evidence or allegations of political or lobbying activities to the PARC. In addition, the IRS's updated desk guide as of February 2017 states that, when a political campaign intervention referral meets the definition of a committee referral, the case file will be forwarded to the PARC. The desk guide defines a committee referral as referrals containing evidence or allegations of impermissible political activities. Under the desk guide procedures, committee referrals containing evidence or allegations of impermissible political activities are required to be sent to the PARC.

<sup>25</sup> See Appendix VII.



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*Review of the Processing of Referrals Alleging  
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**Appendix I**

*Detailed Objective, Scope, and Methodology*

Our overall objective was to assess the IRS's efforts to evaluate allegations of impermissible political activity by tax-exempt organizations. To accomplish our objective, we:

- I. Evaluated existing procedures related to receiving and evaluating referrals.
  - A. Interviewed the front-line manager and the staff responsible for receiving and working referrals to obtain an overall understanding of the referral process and how the referrals are accounted for and evaluated.
  - B. Interviewed PARC members and classifiers to obtain an understanding of the referral process.
  - C. Obtained and reviewed desk procedures for processing referrals to determine if they were consistent with IRM requirements.
- II. Determined if referrals involving allegations of impermissible political activity by tax-exempt organizations were forwarded to the PARC.
  - A. Obtained a referral inventory list from the RCCMS for the period of July 17, 2015, through August 17, 2016.
  - B. Selected a stratified<sup>1</sup> statistical sample of 95 referrals from the RCCMS database of 6,539 referrals<sup>2</sup> using a 95 percent confidence interval, a precision rate of  $\pm 9$  percent, and an expected error rate of 16.5 percent.<sup>3</sup> We obtained the related case documents and determined if referrals involving allegations of impermissible political activity were forwarded to the PARC.
  - C. Calculated potential outcomes related to reliability of information for referrals containing allegations of impermissible political activity that were not forwarded to the PARC for review.

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<sup>1</sup> We divided our sample into three strata based on the referral type input in the RCCMS: Strata 1 – Regular referrals, Strata 2 – Referrals forwarded to committees and various other types of referrals not included in Strata 1 or 3, and Strata 3 – Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. No. 97-248) referrals, misrouted referrals, and referrals with no referral type listed.

<sup>2</sup> \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*

<sup>3</sup> The expected error rate was derived from the actual error rate identified in an initial pilot sample of 30 cases. A contract statistician assisted with developing the sampling plan based on the pilot sample results.



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*Review of the Processing of Referrals Alleging  
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- III. Determined if all referrals sent to the PARC between July 17, 2015, and August 17, 2016, met the requirements for being forwarded to the PARC, and if case files included adequate documentation.
- A. Obtained a list of referrals sent to the PARC between July 17, 2015, and August 17, 2016.
  - B. Reviewed all cases sent to the PARC and determined if the referrals met the criteria for being reviewed by the PARC.
  - C. Reviewed all classifier and PARC member documentation to determine if case documentation was adequate.

**Validity and reliability of data from computer-based systems**

Due to the number of referrals received by the EO function Classification Unit from various sources, we determined that it would not be practical to test the completeness of all incoming referrals. However, we did perform tests to assess the reliability of the referrals data from the RCCMS by: 1) reviewing the data for obvious errors in accuracy and completeness in key data fields, 2) selecting a random sample of cases from each strata in our statistical sample to verify that the key data fields matched source documentation from referral case files, and 3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: policies and procedures for reviewing referrals and documenting actions taken and the rationale for decisions made. We evaluated these controls by interviewing EO function Classification Unit management and classifiers, interviewing PARC members, evaluating information on the RCCMS, reviewing a sample of referrals to determine if they met the criteria for being forwarded to the PARC, and reviewing all case documentation for referrals that were forwarded to the PARC.



*Review of the Processing of Referrals Alleging  
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## **Appendix II**

### *Major Contributors to This Report*

Gregory Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Troy Paterson, Director

Thomas Seidell, Audit Manager

Cheryl Medina, Acting Audit Manager

Jennifer Burgess, Lead Auditor



*Review of the Processing of Referrals Alleging  
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**Appendix III**

*Report Distribution List*

Deputy Commissioner for Services and Enforcement  
Acting Assistant Deputy Commissioner, Government Entities/Shared Services, Tax Exempt and  
Government Entities Division  
Director, Exempt Organizations, Tax Exempt and Government Entities Division  
Director, Office of Audit Coordination



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*Review of the Processing of Referrals Alleging  
Impermissible Political Activity by Tax-Exempt Organizations*

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## **Appendix IV**

### *Outcome Measure*

This appendix presents detailed information on the measurable impact that our recommended corrective action will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

#### **Type and Value of Outcome Measure:**

- Reliability of Information – Potential; 1,011 referrals involving allegations of impermissible political activity that were not forwarded to the PARC for review as required (see page 10).

#### **Methodology Used to Measure the Reported Benefit:**

During the period of July 17, 2015, through August 17, 2016, the EO function Classification Unit received 6,539 referrals that were entered into the RCCMS. We selected a statistically valid stratified sample<sup>1</sup> of 95 out of the 6,539 referrals to determine if they contained allegations of political campaign intervention or lobbying, and if so, whether or not they were correctly sent to the PARC. Our review determined that 11 (12 percent) of the 95 referrals involved allegations of impermissible political activity by tax-exempt organizations. None of the allegations were forwarded to the PARC. As shown in Figure 1, we estimate that 1,011 referrals<sup>2</sup> with allegations of political campaign intervention or lobbying were not forwarded to the PARC for review as required.

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<sup>1</sup> We divided our sample into three strata based on the referral type input in the RCCMS: Strata 1 – Regular referrals, Strata 2 – Referrals forwarded to committees and various other types of referrals not included in Strata 1 or 3, and Strata 3 – Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. No. 97-248) referrals, misrouted referrals, and referrals with no referral type listed.

<sup>2</sup> The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 455 and 1,566.



*Review of the Processing of Referrals Alleging  
Impermissible Political Activity by Tax-Exempt Organizations*

**Figure 1: Summary of Referrals Alleging Impermissible Political Activity  
That Were Not Forwarded to the PARC by Referral Type**

| Strata  | Total<br>Number<br>of<br>Referrals | Sample<br>Size | Referrals Alleging Impermissible<br>Political Activity That Were Not<br>Forwarded to the PARC |                         |                    |
|---|------------------------------------|----------------|---|-------------------------|--------------------|
|   |                                    |                | Number<br>in Sample   | Percentage<br>in Sample | Estimated<br>Total |
| 1. Regular referrals  | **1**                              | *1*            | *1*   | **1**                   | *1*                |
| 2. Referrals forwarded<br>to committees and<br>various other types of<br>referrals not included<br>in Strata 1 or 3                   | **1**                              | *1*            | *1*   | *1*                     | *1*                |
| 3. Tax Equity and Fiscal<br>Responsibility Act<br>referrals, misrouted<br>referrals, and<br>referrals with no<br>referral type listed | 583                                | 20             | 0   | 0%                      | 0                  |
| <b>Totals</b>   | <b>6,539</b>                       | <b>95</b>      | <b>11</b>   |                         | <b>1,011</b>       |

Source: TIGTA case analysis and statistical projections.





*Review of the Processing of Referrals Alleging  
Impermissible Political Activity by Tax-Exempt Organizations*

**Appendix V**

*Classifications Lead Sheet Template*

The following is the template for a Classifications Lead Sheet. In Section I, the classifier is required to document the referred issue, the facts from the referral, the relevant tax laws, and the classifier's conclusion.

**Figure 1: Classifications Lead Sheet Template<sup>1</sup>**

| Classifications Lead Sheet for Committee Cases      |          |     |                                |         |  |  |
|---|----------|-----|--------------------------------|---------|--|--|
| EIN   |          | MFT |                                | Year(s) |  |  |
|   |          |     |                                |         |  |  |
| Classifier  |          |     |                                |         |  |  |
| EO Name   |          |     |                                |         |  |  |
| Address   |          |     |                                |         |  |  |
| COMPLETED BY REVENUE AGENT (SECTIONS I - IV)        |          |     |                                |         |  |  |
| SECTION I - RECOMMENDATION                          |          |     |                                |         |  |  |
| Not Selected  | Selected |     | Other actions deemed necessary |         |  |  |
|   |          |     |                                |         |  |  |
| RECOMMENDATION: Referred Issue/Facts/Law/Conclusion |          |     |                                |         |  |  |
|   |          |     |                                |         |  |  |

<sup>1</sup> EIN refers to the Employee Identification Number; MFT refers to Master File Tax; Form 990, *Return of Organization Exempt from Income Tax*, is filed by tax-exempt organizations, nonexempt charitable trusts, and section 527 political organizations; and IDRS refers to the Integrated Data Retrieval System. Accurant is an online product that offers access to asset/locator information.



*Review of the Processing of Referrals Alleging  
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| <b>FORM 990 REVIEW/EXAM POTENTIAL/LARGE UNUSUAL QUESTIONABLE ITEMS</b> |
|  |

**SECTION II-WEBSITE INFORMATION**

|   |
|---|
| <b>ORGANIZATION WEBSITE</b>   |
| <b>Does the Organization Have a Valid Website? If so, Enter web address</b>   |
|   |
| <b>Describe contents (activities, programs/services) and list any significant items of interest<br/>(upload <u>relevant</u> information to RCCMS)</b> |

**SECTION III-OTHER RESEARCH**

|   |             |  |
|---|-------------|--|
| <b>Search for information regarding the EO, Related EO and Interested Individuals</b> |             |  |
| <b>Internet Research</b>  | <b>DATE</b> | <b>Research and Issues Found<br/>(upload <u>relevant</u> information to RCCMS)</b> |
| <b>INTERNET</b>   |             |  |
| <b>IDRS</b>   |             |  |
| <b>ACCURINT</b>   |             |  |
| <b>OTHER</b>  |             |  |

Source: *Classifications Lead Sheet used for PARC referrals during the time of our review.*<sup>2</sup>

<sup>2</sup> The Classifications Lead Sheet has since been revised.



## Classifier Documentation Examples

**Figure 1: Classifications Lead Sheet Example #1**

[illegible]

<sup>2</sup> Appendix V includes the template for a Classifications Lead Sheet, which shows what information is required to be included.



## Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations

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## Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations

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|-------------|
| *****1***** |
| *****1***** |
| *****1***** |
| *****1***** |
| *****1***** |

Source: \*\*\*\*\*/\*\*\*\*\*

Figure 2 provides \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*

**Figure 2: Classifications Lead Sheet Example #2**

| RECOMMENDATION: Referred Issue/Facts/Law/Conclusion |
|---|
| *****1*****   |
| *****1*****   |
| *****1*****   |
| *****1*****   |
| *****1*****   |
| *****1*****   |

Source: \*\*\*\*\*/\*\*\*\*\*



*Review of the Processing of Referrals Alleging  
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**Appendix VII**

*Management's Response to the Draft Report*



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

August 1, 2018

MEMORANDUM FOR MICHAEL E. McKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: David W. Horton *David W. Horton*  
Acting Commissioner, Tax-Exempt and Government  
Entities Division (TE/GE)

SUBJECT: Draft Audit Report – Review of the Processing of Referrals  
Alleging Impermissible Political Activity by Tax-Exempt  
Organizations (Audit # 201610025)

Thank you for the opportunity to review the draft audit report titled: "Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations (Audit # 201610025)." According to the report, in 2015 "the Senate Committee on Finance recommended that TIGTA review the recently-enacted EO procedures to determine if (1) the process enables the IRS to impartially evaluate allegations of impermissible political activity; (2) any of the referrals have resulted in the IRS opening an examination related to political activity, and if so, whether such an examination was warranted; and (3) the IRS should make further modifications to ensure that it carries out the enforcement function in a fair and impartial manner."

We concur in your finding that all 19 referrals sent to the Political Activities Referral Committee (PARC) were "independently reviewed," that "the final decision ... to examine was based on a majority vote," and that "all 19 referrals were high-profile and involved extremely sensitive allegations." You also found no indication that classifiers and PARC members considered the "political leanings of the organizations when making their determinations" and no evidence of bias in the decision-making process.

However, the IRS disagrees that "allegations of political campaign intervention or excessive lobbying were not forwarded to the PARC for review as required." Based on a sample of 95 referrals, the report concludes that 11 of those referrals alleging impermissible political activity should have been forwarded to the PARC but were not. As the report notes, the decision to refer a case to the PARC is by necessity an "analysis of often unique facts and circumstances of unverified information." On review of the 11 cases, we have confirmed that each referral did not warrant advancement to the PARC because the allegation was incomplete or inapplicable. In more than one



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instance the allegation was unrelated to any lobbying, legislative or potential political activity. In some cases, allegations of lobbying were made with respect to organizations that were legally allowed to engage in unlimited legislative and limited lobbying activity. In other cases, allegations of lobbying were made regarding entities that had legally elected lobbying activity subsequent to their original application for exempt organization status. Given limited resources, the IRS must forward to the PARC only those referrals that are procedurally sufficient.

We also disagree with your extrapolation from the 11 referrals. As the report notes, the IRS received over 6,500 referrals during the 12-month period of the audit. TIGTA did not control the population for issues such as duplicate Taxpayer Identification Numbers. Consequently, we believe the extrapolation is not statistically sound.

We appreciate the opportunity to review and comment on the draft report. The IRS continuously revises procedures to ensure that TE/GE personnel continue to operate in an unbiased and appropriate manner. Consequently, many of TIGTA's recommendations have already been implemented.

Attached is a detailed response outlining our corrective actions to address your recommendations. If you have any questions, please contact me, or a member of your staff may contact Justin L. Abold-LaBreche, Acting Director, Government Entities and Shared Services, at (202) 317-8870.

Attachment



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*Review of the Processing of Referrals Alleging  
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Attachment

**Corrective Actions for TIGTA Draft Audit Report –  
Review of the Processing of Referrals Alleging Impermissible Political Activity  
by Tax-Exempt Organizations (Audit # 201610025)**

**RECOMMENDATION 1:**

The Acting Commissioner, TE/GE Division, should update procedures to address situations when a PARC majority vote is not reached independently.

**CORRECTIVE ACTION:**

Inasmuch as we already have taken the following actions, we agree with the recommendation. In the course of routine updates to its procedures, TE/GE has already updated IRM 4.75.5 to address situations when a PARC majority vote is not reached independently. More specifically, IRM 4.75.5.5(7) was updated and published on August 19, 2016, stating the following: "Two out of three PARC members must make a forwarding recommendation (majority rule) for the referral to be forwarded to an EO Examination group." This means that two or more PARC members must recommend an examination for the case to move forward to the examination process.

In addition, the applicable Desk Guide provides: "Two of the three members of the PARC must agree on the determination of whether an examination is warranted or not (majority rule)." The Desk Guide further clarifies: "If two members do not agree that the case should be examined, it will not be selected for examination."

**IMPLEMENTATION DATE:**

Completed – IRM published 8/19/2016

**RESPONSIBLE OFFICIAL(S):**

Director, Compliance, Planning and Classification (CP&C),  
Tax-Exempt/Government Entities (TE/GE) Division

**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 2:**

Train classifier personnel on the requirements for consistently documenting related research for cases forwarded to the PARC.

**CORRECTIVE ACTION:**

Inasmuch as we already have taken the following actions, we agree with the recommendation. IRS regularly trains classifier personnel. In training held in April 2018, we emphasized the requirements for consistently documenting related research in Reporting Compliance Case Management System (RCCMS) for cases forwarded to the PARC.





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*Review of the Processing of Referrals Alleging  
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**IMPLEMENTATION DATE:**

Completed - 4/11/2018

**RESPONSIBLE OFFICIAL(S):**

Director, Compliance, Planning and Classification (CP&C), TE/GE Division

**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 3:**

Provide further guidance and training for PARC members to ensure that the rationale for determining whether an examination is warranted is clearly documented.

**CORRECTIVE ACTION:**

Per IRM 4.75.5.5, *Exempt Organizations Examination Procedures, Information Items, Political Activities Referral Committee (PARC)* (8/19/2016): "(3) The PARC is composed of three members selected at random from a pool of all EO Examinations and Ruling and Agreements front-line IR-04 managers. Each member receives appropriate training and serves on a PARC for 24 months as a collateral duty."

Prior to the issuance of the recommendation on May 2, 2018, new PARC members rotated and were trained in the normal course of business in June 2017. The training for new PARC members included discussions on how to use RCCMS for reviews and to ensure that the rationale for determining whether an examination is warranted is clearly documented. Additionally, the Referrals Manager provided one-on-one training for each PARC member on types of documentation to be included in RCCMS.

**IMPLEMENTATION DATE:**

Completed - 6/08/2017

**RESPONSIBLE OFFICIAL(S):**

Director, Compliance, Planning and Classification (CP&C), TE/GE Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls and ensure that PARC members are documenting casework properly.

**RECOMMENDATION 4:**

Quality review a sample of cases forwarded to the PARC to provide reasonable assurance that documentation requirements are met.



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## *Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations*

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### **CORRECTIVE ACTION:**

Inasmuch as we already have taken the following actions, we agree with the recommendation. In the normal course of business, the Referrals Manager conducts periodic quality checks on all referrals, including potential PARC referrals. The last such review was completed in July 2017.

### **IMPLEMENTATION DATE:**

Ongoing

### **RESPONSIBLE OFFICIAL(S):**

Director, Compliance, Planning and Classification (CP&C), TE/GE Division

### **CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls to ensure regular quality checks are periodically conducted.

### **RECOMMENDATION 5:**

The Acting Commissioner, Tax Exempt and Government Entities, should clarify guidance for consistency and train personnel on the requirements for transferring cases to the PARC.

### **CORRECTIVE ACTION:**

Inasmuch as we already have taken the following actions, we agree with the recommendation. In the Referrals Desk Guide (Exempt Organizations Referral Procedures – EO Classifications) dated February 1, 2017, we provided our personnel with detailed processes and procedures related to referrals, including for referrals relating to political campaign intervention (on pages 21 through 26).

All EO Examination Classifiers received the updated Referrals Desk Guide in February 2017. Guidance and group discussions were provided to senior classifiers on transferring cases to the PARC. It is the responsibility of the Group manager to notify the PARC and to ensure PARC members have access to the case and ultimately review it. Each PARC member received formalized training and understands how a case comes to them, how they review the case and how the case is returned back to the Referrals manager.

### **IMPLEMENTATION DATE:**

Ongoing

### **RESPONSIBLE OFFICIAL(S):**

Director, Compliance, Planning and Classification (CP&C), TE/GE Division

### **CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls, and as classifiers rotate, we will provide updated guidance and training as needed.



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*Review of the Processing of Referrals Alleging  
Impermissible Political Activity by Tax-Exempt Organizations*

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## **Appendix VIII**

### *Office of Audit Comments on Management's Response*

In response to our draft report, the Acting Commissioner, Tax Exempt and Government Entities Division, included some general comments and assertions that we believe warrant additional comment. We have included portions of management's response and our related comments below.

**Management Statement:** *[TIGTA] also found no indication that classifiers and PARC members considered the "political leanings of the organizations when making their determinations" and no evidence of bias in the decision-making process.*

**Office of Audit Comment:** We believe IRS management's statement needs to be clarified. Our report focused on PARC member documentation because PARC members are the officials who make decisions on whether PARC cases should be examined. In addition, classifiers often summarize the allegations received. The summaries are based on the information contained in referrals that frequently comment on the political leanings of referred organizations. For these two reasons, our report did not comment on whether classifiers considered the political leanings of organizations. In addition, while our report did not state that there was no evidence of bias in the decisionmaking process, we verified that a process put in place to reduce the risk of political bias was followed for all 19 cases forwarded to the PARC. As stated in our report, "We found that PARC members' documentation did not mention the political leanings of the organizations when making their determinations."

**Management Statement:** *On review of the 11 cases, we have confirmed that each referral did not warrant advancement to the PARC because the allegation was incomplete or inapplicable. In more than one instance the allegation was unrelated to any lobbying, legislative or potential political activity. In some cases, allegations of lobbying were made with respect to organizations that were legally allowed to engage in unlimited legislative and limited lobbying activity. In other cases, allegations of lobbying were made regarding entities that had legally elected lobbying activity subsequent to their original application for exempt organization status. Given limited resources, the IRS must forward to the PARC only those referrals that are procedurally sufficient.*

**Office of Audit Comment:** We disagree with this statement. In our review of the 11 cases, we found that each referral contained either a statement on the referral form, or an attachment with the referral, alleging impermissible political activity. While some referrals contained allegations against organizations that were allowed to either conduct



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## *Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations*

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limited or unlimited lobbying activity, those activities must not be substantial<sup>1</sup> or must be in furtherance of the organizations' tax-exempt purpose.

As stated in the report, the 11 cases met IRS criteria to be forwarded for review by the PARC. IRM guidelines state that referrals containing evidence or allegations of political or lobbying activities will be forwarded to the PARC. The Referrals Desk Guide also states that committee referrals, which include referrals containing evidence or allegations of impermissible political activities, are required to be sent to the PARC. The IRS's procedures do not give the classifiers discretion in determining which allegations of impermissible political activity are sufficient to be forwarded to the PARC. The IRS's procedures also do not allow for the classifiers to determine which lobbying activities should be considered excessive or allowable for specific types of organizations.

**Management Statement:** *We also disagree with your extrapolation from the 11 referrals. As the report notes, the IRS received over 6,500 referrals during the period of the audit. TIGTA did not control the population for issues such as duplicate Taxpayer Identification Numbers. Consequently, we believe the extrapolation is not statistically sound.*

**Office of Audit Comment:** This statement is not accurate. During the audit period, we requested all of the referrals received and entered into the RCCMS. Because each referral entered into the RCCMS database is assigned a unique control number, we used the control number as the unique identifier to determine the number of referrals received between July 17, 2015, and August 17, 2016. In some instances, there were multiple referrals received and entered into the RCCMS with the same Taxpayer Identification Number, but with different control numbers. As such, these referrals were included in our population because they were separate referrals received, and our population controlled the number of referrals received during the period of the audit. We verified our results with a statistician, who concurs that our population and sampling projection are statistically valid.

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<sup>1</sup> If an organization has elected the expenditure test under Section 501(h), it may lose its tax-exempt status if it engages in excessive lobbying activity over a four-year period.