

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



## **Fiscal Year 2019 Statistical Trends Review of the Tax Exempt and Government Entities Division**

May 3, 2021

Report Number: 2021-10-031

**HIGHLIGHTS: Fiscal Year 2019 Statistical Trends Review of the Tax  
Exempt and Government Entities Division**

**Final Audit Report issued on May 3, 2021**

**Report Number 2021-10-031**

**Why TIGTA Did This Audit**

The purpose of this review was to compile nationwide statistical information and complete trend analyses of activities for the IRS's Tax Exempt and Government Entities (TE/GE) Division from Fiscal Years (FY) 2015 through 2019. The overall objective of this review was to provide various statistical information and data trends related to the TE/GE Division.

**Impact on Taxpayers**

This report provides statistical information for major functions of the TE/GE Division. Nationwide data from IRS management information systems were used during our review. The TE/GE Division has oversight responsibility for a significant portion of the country's economy. Although TE/GE Division customers are exempt from taxation on their income, they control more than \$31 trillion in assets and may be subject to other Federal taxes, such as excise and employment taxes.

**What TIGTA Found**

The TE/GE Division is comprised of seven distinct functions: Employee Plans; Shared Services; Compliance Planning and Classification; and Exempt Organizations/Government Entities, which is comprised of the Exempt Organizations, Indian Tribal Governments, Tax-Exempt Bonds, and Federal, State, and Local (Governments)/Employment Tax functions. According to the IRS, the entities that the TE/GE Division serves employ almost 25 percent of the American workforce.

In May 2017, the TE/GE Division realigned the issue identification, planning, classification, and case delivery processes that were previously embedded within five functions into the consolidated Compliance Planning and Classification function. The reorganization has affected these five functions' examinations units' staffing, budget, and processes. In addition, in October 2018, the TE/GE Division established five new compliance groups, referred to as the TE/GE Compliance Unit, which in FY 2019 completed 4,863 compliance checks for three of the functions resulting in a 72 percent change rate.

New legislation often affects IRS operations and may require significant operational changes to implement it. Two new laws significantly affected the TE/GE Division's operations during the years 2015 to 2019: the Tax Cuts and Jobs Act of 2017, and the Taxpayer First Act of 2019. In addition to legislative changes, the Federal Government had a lapse in appropriations from December 22, 2018, to January 25, 2019, that shut down most IRS operations for 35 days. As a result, the TE/GE Division experienced inventory backlogs in processing applications for tax-exempt status and timely completing compliance cases. However, IRS management stated that mitigation actions taken, such as allowing temporary overtime and detailing examination agents from one unit to another, addressed the backlogs of applications.

Over the FYs 2015 to 2019, the TE/GE Division's budget decreased by more than \$22.5 million (9 percent), although the FY 2019 budget increased by approximately \$7.7 million (4 percent) over FY 2018's appropriations. Along with the decrease in the budget, the TE/GE Division's staffing level also decreased by 12 percent from FY 2015 to FY 2019, although hiring efforts in FY 2019 have started improving staffing levels. At the end of FY 2019, the TE/GE Division had approximately 1,500 employees, which was 2 percent of the IRS's total staffing level of just over 78,000 employees.

**What TIGTA Recommended**

TIGTA made no recommendations in this report. IRS officials were provided an opportunity to review the draft report and did not provide a formal response.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

## U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 3, 2021

### MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

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

**SUBJECT:** Final Audit Report – Fiscal Year 2019 Statistical Trends Review of the Tax Exempt and Government Entities Division (Audit # 202010020)

This report presents the results of our review of various statistical information and data trends related to the Tax Exempt and Government Entities Division. The purpose of this review was to compile nationwide statistical information and complete trend analyses of activities for the Internal Revenue Service's (IRS) Tax Exempt and Government Entities Division for Fiscal Years 2015 through 2019. This review is part of our Fiscal Year 2021 Annual Audit Plan and addresses the major management and performance challenge of *Achieving Operational Efficiencies*.

Although we made no recommendations in this report, we provided IRS officials an opportunity to review the draft report. IRS management did not provide us with any report comments.

If you have any questions, please contact me or Heather Hill, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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## **Background**

The mission of the Tax Exempt and Government Entities (TE/GE) Division is to provide TE/GE Division customers top quality service by helping them understand and comply with applicable tax laws and to protect the public interest by applying the tax law with integrity and fairness to all. The TE/GE Division has important responsibilities for both the oversight of regulatory compliance as well as compliance with tax requirements. It is responsible, for example, for the qualification and tax treatment of retirement plans, the administration of Federal tax laws applicable to tax-exempt bonds, and the verification of organizations' compliance with requirements for tax exemption.

This report provides statistical information for major functions of the TE/GE Division. Nationwide data from Internal Revenue Service (IRS) management information systems were used during our review. Due to time and resource constraints, we did not audit the IRS systems to validate the accuracy and reliability of that information. We did not assess internal controls because doing so was not applicable within the context of our objective. Our analyses were limited to identifying changes and trends in IRS data. In addition, the Treasury Inspector General for Tax Administration (TIGTA) issues a compliance trends report every year that includes some TE/GE Division data. The current compliance trends review and this review did not always use the same data sources, so the reported information may differ.

**This report provides  
statistical information for  
all major functions of the  
TE/GE Division.**

Most of the calculations throughout the report and appendices are affected by rounding. All initial calculations were performed using the actual numbers rather than the rounded numbers that appear in the report.

## **Results of Review**

This report provides statistical information for the TE/GE Division as a whole, as well as each of its functions separately. Each function is different, so not every topic is included in each report section. In addition, some functions have unique information topics that are not included in any other function's section.

### **Section 1 - Overall TE/GE Division**

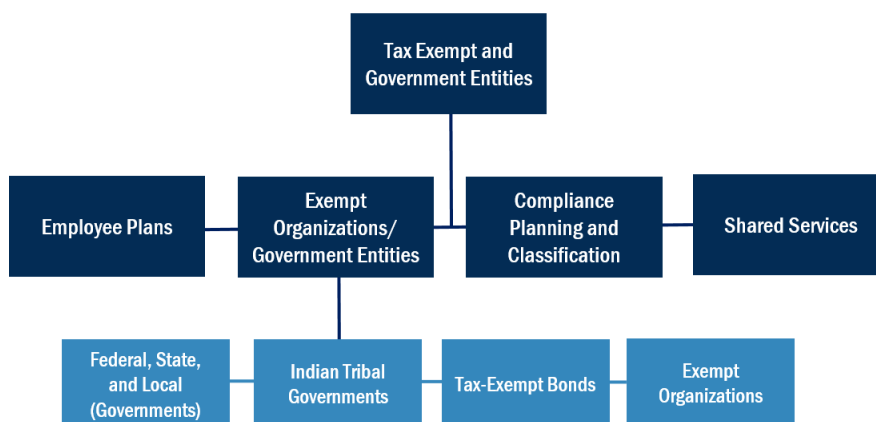
The TE/GE Division serves charities, small local community organizations, major universities, large pension funds, small business retirement plans, local and State governments, participants in complex tax-exempt bond transactions, and Indian tribal governments and tribal associations. The TE/GE Division is comprised of seven distinct functions:

- Employee Plans (EP).
- Exempt Organizations (EO)/Government Entities, which is comprised of:

- Federal, State, and Local (Governments)/Employment Tax (FSL/ET) functions.<sup>1</sup>
- Indian Tribal Governments (ITG).
- Tax-Exempt Bonds (TEB).
- EO.
- Compliance Planning and Classification (CP&C).
- Shared Services.

Figure 1 shows the organizational structure of the TE/GE Division.

**Figure 1: TE/GE Division Organization Chart**



*Source: TE/GE Connect IRS intranet website as of October 2, 2020.*

At the end of Fiscal Year (FY) 2019, the TE/GE Division had approximately 1,500 employees, which was 2 percent of the IRS's total staffing level of just over 78,000 employees.<sup>2</sup> However, the TE/GE Division has oversight responsibility for a significant portion of the country's economy. Although the TE/GE Division's customers are exempt from taxation on their income, they contribute substantially to the economy because they control more than \$31 trillion in assets and may be subject to other Federal taxes, such as excise and employment taxes. In addition, according to the IRS, TE/GE Division entities employ almost 25 percent of the American workforce.

## Challenges

New legislation often affects IRS operations and may require significant operational changes to implement it. Two new laws significantly affected the TE/GE Division's operations during FYs 2015 to 2019.

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<sup>1</sup> In mid-Fiscal Year 2017, the Federal, State, and Local Governments function transitioned from a standalone organization to a part of the EO function and was renamed the FSL/ET function. It was later moved under the Government Entities function.

<sup>2</sup> Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

- The Tax Cuts and Jobs Act of 2017 contains 119 tax provisions and is the most significant tax reform legislation in more than 30 years.<sup>3</sup> Several of the tax provisions affected the TE/GE Division - specifically in the EP, EO, and TEB functions. A recent TIGTA review of 26 key provisions of the Act found that the IRS had to revise forms, develop guidance, and update computer programming.<sup>4</sup>
- The Taxpayer First Act of 2019, effective in FY 2020, mandates electronic filing of annual information returns for all tax-exempt organizations and requires the IRS to notify tax-exempt organizations that their tax-exempt status will be revoked if an annual return is not filed by the due date for the next such return.<sup>5</sup>

In addition to legislative changes, the Federal Government had a lapse in appropriations from December 22, 2018, to January 25, 2019, that shut down most IRS operations for 35 days. As a result, the TE/GE Division experienced inventory backlogs in processing applications for tax-exempt status and timely completing compliance cases. However, IRS management stated that mitigation actions taken, such as allowing temporary overtime and detailing examination agents from one unit to another, addressed the backlogs of applications.

In addition, several TE/GE Division reorganizations have taken place during FYs 2015 through 2019 that may have affected the accomplishments reported, including one major reorganization in FY 2017. On May 1, 2017, the TE/GE Division realigned the issue identification, planning, classification, and case delivery processes for examinations that were previously embedded within five divisional functions, EP, EO, FSL/ET, ITG, and TEB, into the consolidated CP&C function. This reorganization greatly affected these five functional examinations units' staffing, budget, and processes. TIGTA recently reported that, although the reorganization created benefits, IRS management did not develop performance metrics to measure progress towards achieving reorganization goals, and TE/GE Division leadership therefore cannot determine if the CP&C function improved processes as intended.<sup>6</sup>

Another organizational change occurred in October 2018, when the TE/GE Division established under the Government Entities function five new compliance groups referred to as the TE/GE Compliance Unit (TECU). The TECU completes compliance checks and issues letters to taxpayers to improve return filings and filing accuracy on issues of noncompliance.<sup>7</sup> During FY 2019, this Unit completed 4,863 compliance checks for the EP, EO, and FSL/ET functions resulting in a 72 percent change rate.<sup>8</sup>

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<sup>3</sup> An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for FY 2018, Pub. L. No. 115-97, 131 Stat. 2054.

<sup>4</sup> TIGTA, Report No. 2019-44-030, *Interim Results of the 2019 Filing Season*, pp. 1, 3 (Apr. 2019).

<sup>5</sup> Pub. L. No. 116-25, § 3101 and § 3102, 133 Stat. 981.

<sup>6</sup> TIGTA, Report No. 2021-10-005, *Consolidation of Examination Case Selection and Assignment in the Tax Exempt and Government Entities Division Created Benefits, but Additional Improvements Are Needed*, pp. 2-4 (Dec. 2020).

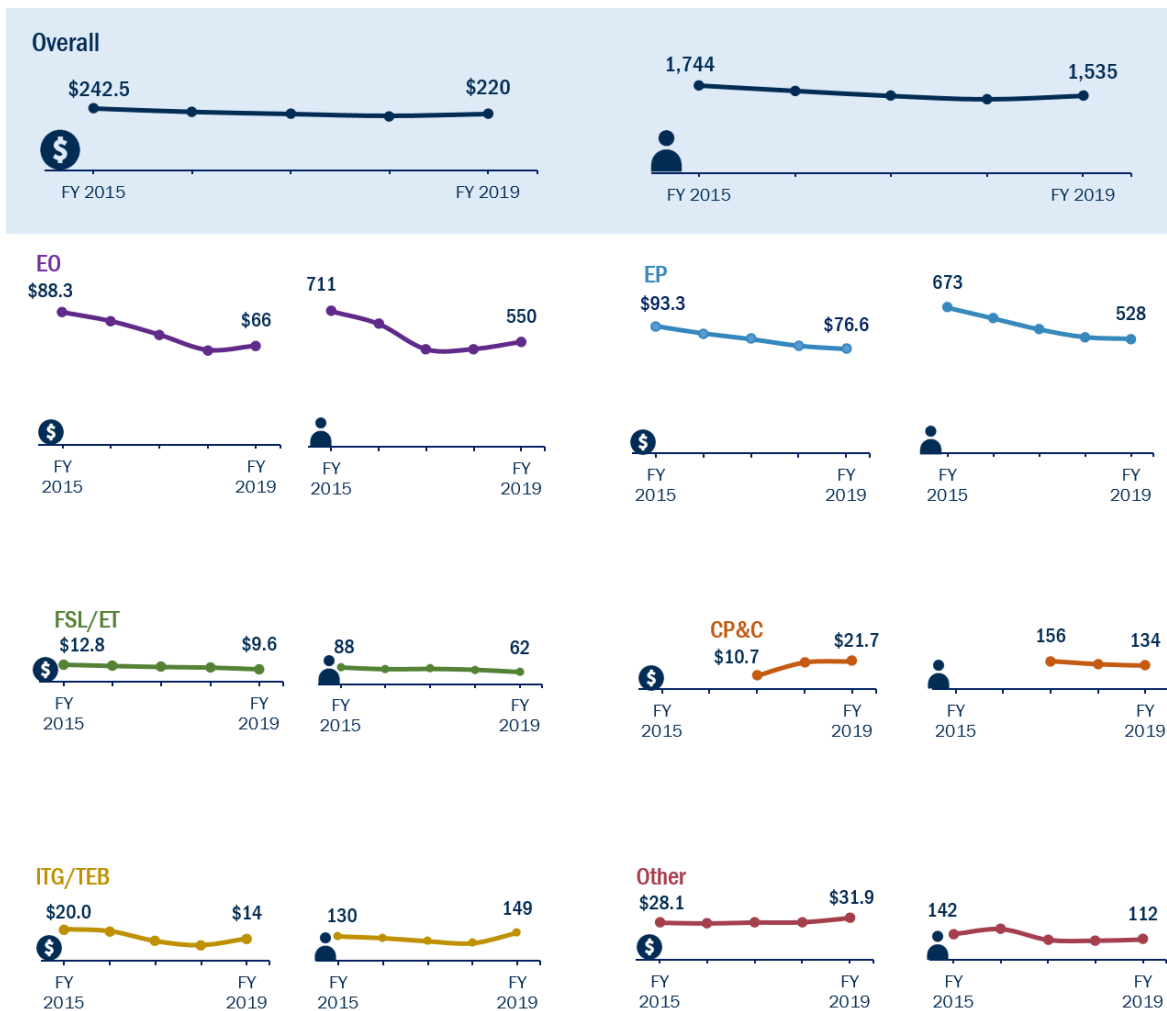
<sup>7</sup> The IRS uses non-examination reviews called compliance checks to determine whether specific items have been reported properly. Like examinations, compliance checks are an accountability tool but are simpler, less burdensome, and limited in scope. A compliance check is not an examination as it does not directly relate to determining a tax liability for any particular period.

<sup>8</sup> Change cases are cases in which the examination results in a change (or adjustment) in the organization's status or tax liability. The change rate is the percentage of cases processed that resulted in a change.

## Resources

From FY 2015 to FY 2019, the TE/GE Division's budget decreased by more than \$22.5 million (9 percent), although the FY 2019 budget increased by approximately \$7.7 million (4 percent) over FY 2018's appropriations. Figure 2 shows the changes in the TE/GE Division's budget and staffing levels.<sup>9</sup>

**Figure 2: TE/GE Division Budgeted Resources (in millions) and Staffing Levels<sup>10</sup>**



Source: Integrated Financial System data and Human Resources Reporting Center.

Along with the decrease in the budget, the TE/GE Division's staffing level also decreased by 12 percent during the same five fiscal years, although hiring efforts in FY 2019 have started improving staffing levels. In addition, the May 2017 reorganization reallocated budget and staffing resources from the individual functions to the CP&C function.

<sup>9</sup> Due to the reorganizations, not all staffing information was available separately for the ITG and TEB functions. ITG and TEB functions' budget totals were combined for presentation purposes of this report.

<sup>10</sup> The "Other" category is mainly comprised of the TE/GE Division's Shared Services function, which includes the offices of Business Systems Planning, Communications and Liaison, and Human and Capital Resources. These offices provide strategic and operational support to all functions within the TE/GE Division.



## **Section 2 – Employee Plans Function**

The EP function has oversight responsibility for all employee retirement plans (including the qualification of pension, annuity, profit sharing, stock bonus plans, simplified employee pensions, saving incentive match plans for employees, and tax sheltered annuities) and related trusts. Its oversight also includes tax treatment of participants and their beneficiaries, and deductions for employer contributions, as well as procedural and administrative provisions with respect to such plans.

The EP function accomplishes its mission by:

- Processing determination letter requests from employers regarding the qualified status of their pension, annuity, profit sharing, and stock bonus plans and providing determination letters to the employers.
- Developing and operating a voluntary correction program for employers to correct issues with their plans and enter into closing agreements, and examining returns to protect the interests of the employee plan participants and beneficiaries.
- Coordinating tax administration and sharing enforcement activities with the U.S. Department of Labor and the Pension Benefit Guaranty Corporation.<sup>11</sup>

Employers can establish either individually designed plans or pre-approved plans,<sup>12</sup> specifying the type of plan: Defined Benefit or Defined Contribution.<sup>13</sup> According to the Department of Labor, the shift from Defined Benefit to Defined Contribution Plans has been ongoing over the past 40 years, and research shows that both changes in firm behavior and in worker characteristics are factors in this trend. Employers or plan administrators maintaining a benefit plan covered by the Employee Retirement Income Security Act of 1974 must report both Defined Benefit and Defined Contribution Plans to the Department of Labor, on the Form 5500 series of returns, which then provides the forms to the IRS.<sup>14</sup>

The Department of Labor reported that the amount of assets held by pension plans in Plan Year 2017 was almost \$9.8 trillion, which was comprised of nearly \$6.6 trillion Defined Contribution assets and just over \$3.2 trillion Defined Benefit assets. The Department of Labor also reported that in Plan Year 2017, pension plans paid \$737.4 billion in benefits to

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<sup>11</sup> The Pension Benefit Guaranty Corporation is a Federal agency created by the Employee Retirement Income Security Act of 1974 to protect pension benefits in private-sector defined benefit plans. The Employee Retirement Income Security Act (Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1001-1461 and in scattered sections of 5, 18, and 26 U.S.C.)) is a Federal law that sets minimum standards for most voluntarily established retirement and health plans in private industry to provide protection for individuals in these plans.

<sup>12</sup> Generally, an individually designed plan is a retirement plan drafted to be used by only one employer. A pre-approved retirement plan is a plan sold to employers by a document provider such as a financial institution or benefits practitioner. The document provider requests IRS approval ("pre-approval") of the plan document, then makes the IRS-approved plan available to adopting employers.

<sup>13</sup> A Defined Benefit Plan promises the participant a specified monthly benefit at retirement. A Defined Contribution Plan is a retirement plan in which the employee and/or the employer contribute to the employee's individual account under the plan.

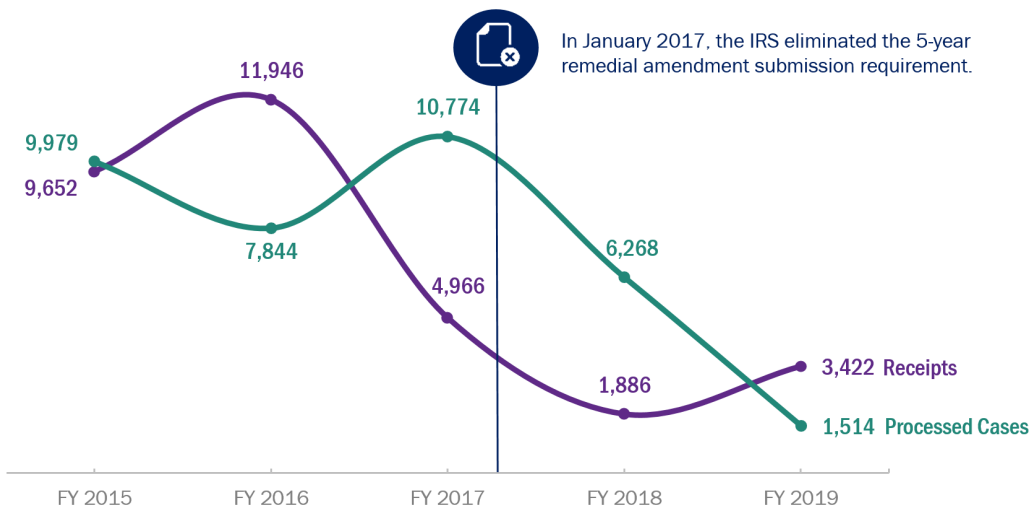
<sup>14</sup> The Form 5500 series includes Form 5500, *Annual Return/Report of Employee Benefit Plan*, Forms 5500 EZ, *Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan*, and Form 5500 SF, *Short Form Annual Return/Report of Small Employee Benefit Plan*. Not all retirement plans are reported on the Form 5500 series, for example, Form 5500-EZ is not required when total plan assets are valued under \$250,000.

137.4 million total participants, including \$243.4 billion disbursed from Defined Benefit plans and \$494 billion from Defined Contribution plans. These payments were made either directly to retirees, beneficiaries, and terminating employees or to insurance carriers for payment of benefits.

## EP determinations

Entities wanting to obtain an opinion from the IRS on their employee plans submit a request for a determination. Although submitting a request for a determination letter is voluntary, employers seek a favorable determination letter to minimize the risk that the IRS will disqualify the plan if later examined. Figure 3 shows the number of determination letter requests received and processed by the EP function.<sup>15</sup>

**Figure 3: Number of Determination Letter Requests Received and Processed**



*Source: EP/EO Determination System.*

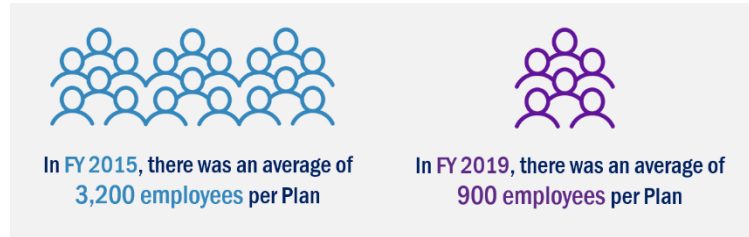
The number of determinations requests received decreased by 65 percent over FYs 2015 through 2019. According to IRS management, the primary reason for this drop was a change in the determination letter submission process. In January 2017, the IRS eliminated the option for plan sponsors to submit a plan amendment for review every five years and now only receives requests to review new plans, plan terminations, and in certain other situations. The EP function approved approximately 34,000 of the more than 36,000 cases processed during the five fiscal years, closed 2,273 without a determination, and denied just one case as a qualified plan.<sup>16</sup> IRS management stated that denials are very rare because plan sponsors may fix any problems with plan language as part of the review of the determination request. Most plan sponsors make recommended changes.

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<sup>15</sup> See Appendix II, Figure 1, for more detailed information on determination letter requests received and processed during FYs 2015 through 2019. See Appendix II, Figure 2, for more details on applications closed by form type.

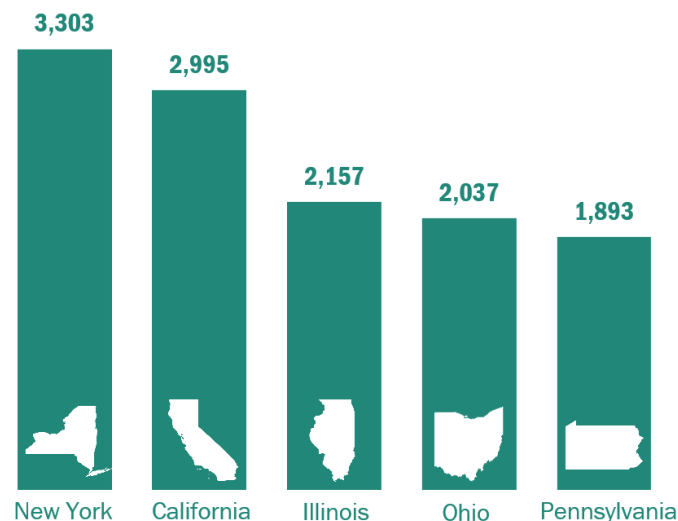
<sup>16</sup> Closures without a determination can occur for different reasons, such as when the application is incomplete or the submitter withdraws the request.

In FY 2015, the IRS closed applications on retirement plans that affected more than 31.9 million employees. By FY 2019, the number of affected employees dropped almost 96 percent to more than 1.4 million, and the average number of employees included in each plan decreased by 71 percent. IRS management stated that the decrease is most likely attributable to the elimination of the requirement for plan sponsors to submit a plan amendment for review every five years. Initial and terminating plans tend to be from small employers, so this likely contributed to the decrease in the number of participants covered by determination letters. An additional reason for the decline is the expansion of the types of plans eligible under the pre-approved plan program. The expansion allows employers to adopt a pre-approved plan instead of an individual designed plan. Employers that use a pre-approved plan file fewer determination letter requests than those that develop an individually designed plan.



Determination requests involved plans that were generally located in the same large States during FY 2015 through FY 2019. Figure 4 shows the top five locations during the five fiscal years.

**Figure 4: States With Most Closed Employee Plans  
Determinations Requests (FYs 2015 Through 2019 Totals)**



*Source: EP/EO Determination System.*

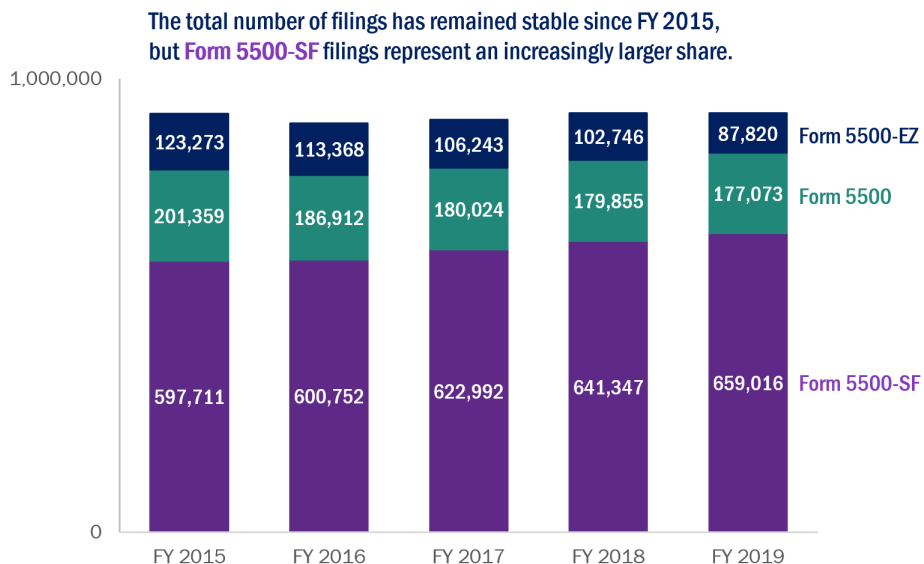
These data give an indication of where businesses with new employee plans are located and could help the TE/GE Division focus where to conduct outreach efforts for the EP function. New York and California were the top two geographic locations each of the five fiscal years.

### **EP annual return filings**

The IRS, Department of Labor, and Pension Benefit Guaranty Corporation jointly developed the Form 5500 series of returns for employee benefit plans. The employer maintaining the plan or the plan administrator files annual returns to report information concerning the qualification of

the plan, its financial condition, investments, and the operations of the plan. Figure 5 shows how many annual information returns were filed for each form.<sup>17</sup>

**Figure 5: Number of Annual  
Information Returns Filed for Each Form**



*Source: EP Master File and Return Transaction File Online.*

While Forms 5500 and 5500-EZ filings declined from FY 2015 through FY 2019, Form 5500-SF filings for small employee benefit plans have increased and made up over 60 percent of total filings each year.

## EP referrals

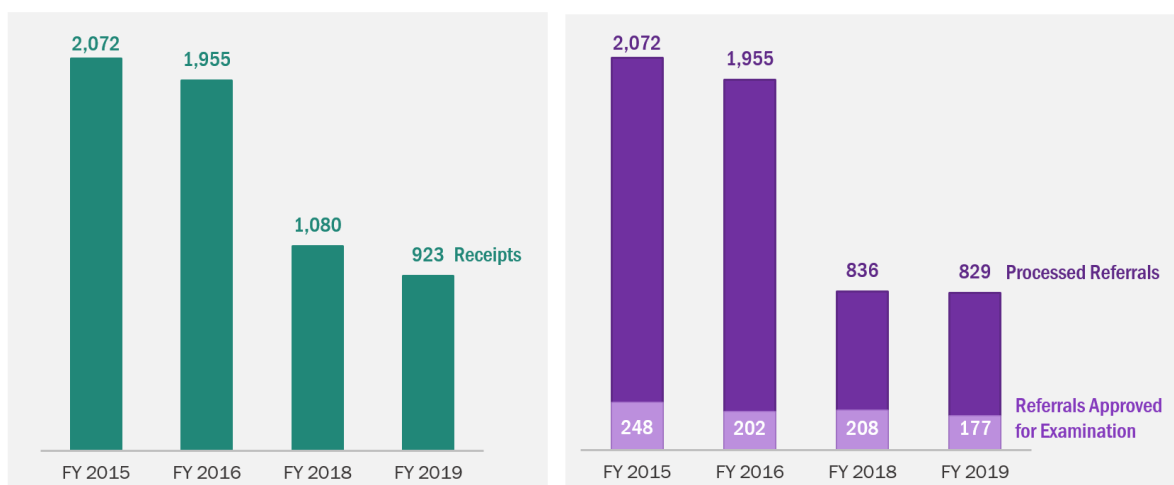
A referral is any communication (information/knowledge) from a third-party or taxpayer alleging potential noncompliance with the tax law. Every year, the IRS receives referrals from the general public, members of Congress, Federal and State government agencies, and internal sources. Figure 6 shows the number of employee plan-related referrals received, processed, and forwarded for examination in FYs 2015, 2016, 2018, and 2019.<sup>18</sup>

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<sup>17</sup> See Appendix II, Figure 3, for a further breakdown of the types of plans related to these information returns.

<sup>18</sup> FY 2017 was a transition year with the creation of the CP&C function, and data were not available in its entirety.

**Figure 6: Number of Referrals Received and Processed for the EP function**



*Source: EP Classification database (FY 2015 – FY 2016); Reporting Compliance Case Management System (FY 2018 – FY 2019).*

We could not determine why there was a drop in EP referrals received from FY 2016 to FY 2018; however, following the FY 2017 creation of the CP&C function, the number of processed referrals remained steady in FYs 2018 and 2019.

Once referrals are processed, those approved for examination are assigned to examiners. The majority of referrals forwarded for examination are from internal sources. The number of closed examinations originating from internal and external referral sources increased 43 percent over the five fiscal years. Figure 7 shows the results of the examinations and whether the case was identified from internal or external sources.

**Figure 7: Results of EP Examinations Identified From Referrals**

|   | FY 2015    | FY 2016    | FY 2017    | FY 2018    | FY 2019    |
|---|------------|------------|------------|------------|------------|
| <b>Total EP Closed Examinations</b>         | <b>180</b> | <b>171</b> | <b>139</b> | <b>179</b> | <b>257</b> |
| Internal Referrals                          | 149        | 137        | 118        | 152        | 184        |
| External Referrals                          | 31         | 34         | 21         | 27         | 73         |
| Percentage of Examinations Closed No Change | 34%        | 30%        | 33%        | 21%        | 21%        |
| <b>Total EP Non-Examined Closures</b>       | <b>33</b>  | <b>50</b>  | <b>45</b>  | <b>33</b>  | <b>75</b>  |
| Internal Referrals                          | 26         | 39         | 38         | 29         | 55         |
| External Referrals                          | 7          | 11         | 7          | 4          | 20         |

*Source: Returns Inventory and Classification System.*

The IRS generally measures unproductive work by the “no change rate,” which is the percentage of examinations that examiners closed with no actions taken. From FY 2015 to FY 2019, no change closures decreased by 13 percent. In addition, examiners may decide to close an assigned case without examining it, referred to as a “survey” or non-examined closure, when research indicates, for example, that the expected noncompliant issue(s) is not present.<sup>19</sup> In a

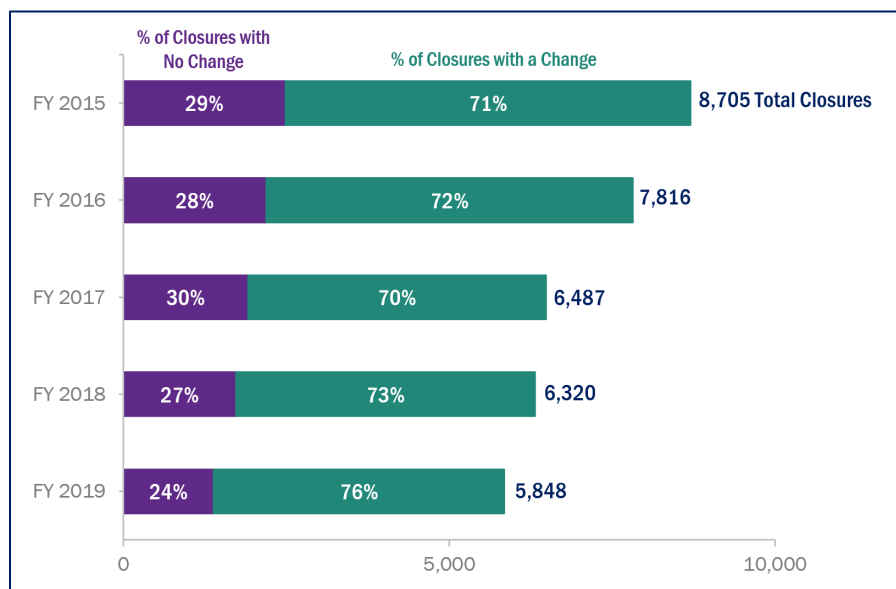
<sup>19</sup> Surveying cases can occur before or after assignment to an examiner, with or without contacting the taxpayer.

recent audit report, TIGTA concluded that these type of cases are generally considered unproductive because classifiers, group managers, and examiners spend time on cases that are never examined.<sup>20</sup> The number of non-examined closures increased by 127 percent from FY 2015 to FY 2019. Several reasons for the non-examined closure increase are presented in the next section of this report.

## EP examinations

The EP function examines returns to protect the interests of the employee plan participants and beneficiaries. Figure 8 shows the number and results of closed EP examinations.

**Figure 8: Number and Results of Closed EP Examinations**



*Source: Returns Inventory and Classification System.*

Although the number of EP function examination closures decreased from 8,705 closures in FY 2015 to 5,848 in FY 2019 (nearly 33 percent), the no change rate decreased by 17 percent over the same period.<sup>21</sup> This indicates that although the EP function is completing fewer examinations, the cases selected are yielding issues worthy of review. The number of closing agreements obtained during examinations were relatively stable from FY 2015 to FY 2019.<sup>22</sup> In addition, on average for the five fiscal years, 0.5 percent of the closed cases resulted in final revocation of the plan.<sup>23</sup>

Although IRS management could not definitely determine what caused the nearly 33 percent decrease in the number of examinations completed, they suggested a possible explanation

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<sup>20</sup> TIGTA, Report No. 2021-10-005, *Consolidation of Examination Case Selection and Assignment in the Tax Exempt and Government Entities Division Created Benefits, but Additional Improvements Are Needed*, p. 11 (Dec. 2020).

<sup>21</sup> A "no change" is an examination resulting in no change to tax liability and there are no issues for which a written advisory is warranted. The no change rate is the percentage of no change cases out of the total examination closures.

<sup>22</sup> Plan qualification issues may be resolved through different types of closing agreements. Plan sponsors may request a closing agreement to resolve certain income or excise tax issues that cannot be corrected through the Employee Plans Compliance Resolution System.

<sup>23</sup> The IRS proposes to revoke an employee plan when an EP examiner raises a qualification issue during the examination of a plan that is not resolved through a closing agreement. A final revocation results when the qualification issue is either not challenged by the taxpayer within a specified period of time or upheld by Tax Court.

could be the increase in the number of change closures during the FY 2015 to FY 2019 period. According to IRS management, the increase in the change rate may have caused an increase in the hours and days needed to work a case, resulting in fewer closed cases. From FY 2015 to FY 2019, examination hours per case increased from 42.3 to 47.5 hours (just over 12 percent). In addition, the average number of days to complete a case increased from 245 to 284 days (16 percent) over the same period. IRS management also believes that collateral assignments by agents, such as details to other offices and training, affected the number of examination closings. These types of assignments prevent agents from processing examination cases resulting in a decrease in the number of examination closings. In addition, IRS officials suggest that EP function staff hiring has not kept pace with attrition over the past five years.

From FYs 2016 through 2019, the number of non-examined case closures increased by nearly 37 percent. IRS management attributed the increase to a surplus in cases that were incorrectly established as inventory due to a typographical error, that were later closed non-examined, as well as a surplus of cases assigned for training purposes, but were never reviewed. In addition, CP&C Classification and Case Assignment Unit closed some cases as non-examined due to excess workload or short statute.<sup>24</sup>

## **EP compliance checks**

The EP function also conducts compliance checks, which are non-examination reviews to determine whether specific items have been reported properly. Figure 9 shows the number and results of compliance checks performed by the EP function, as well as those completed for the EP function by the TECU.

**Figure 9: Number of EP Function Compliance  
Checks Completed, Referred, and Examined**

|                                   | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|-----------------------------------|---------|---------|---------|---------|---------|
| Compliance Check Closures         | 4,009   | 3,665   | 3,768   | 2,768   | 3,131   |
| Referred for Possible Examination | 68      | 79      | 73      | 87      | 113     |
|                                   |         |         |         |         |         |
| Examinations                      | 54      | 57      | 55      | 72      | 84      |
| No Change Examinations            | 18      | 16      | 15      | 12      | 16      |
| Change Examinations               | 36      | 41      | 40      | 60      | 68      |

*Source: Research and Inventory System EP Compliance Unit Database and EP Base Inventory Master File.*

While the number of compliance checks completed has fluctuated, overall it decreased by 22 percent from FY 2015 to FY 2019. IRS management stated that several compliance check strategies approved in September 2018 and planned for FY 2019 were not started while multiple offices collaborated to ensure that the letters and attachments sent to employee plan sponsors

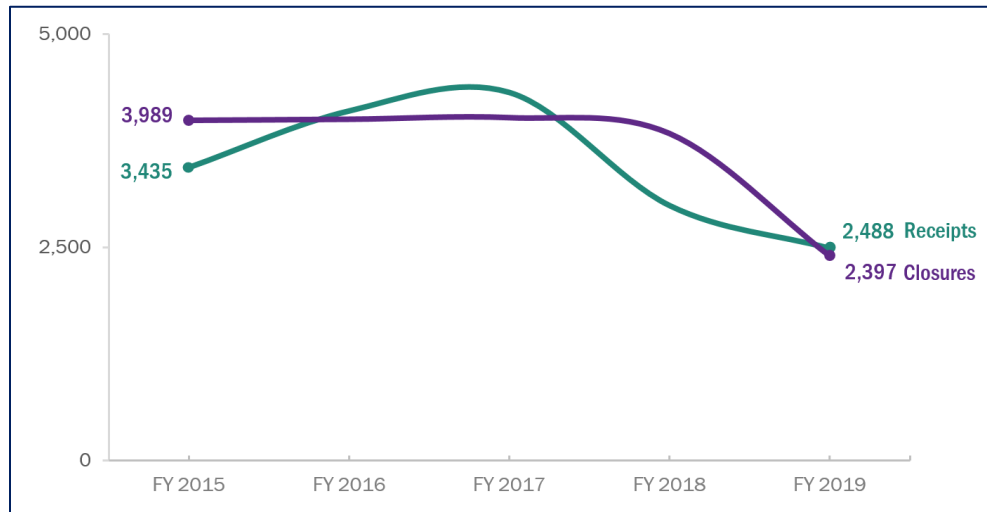
<sup>24</sup> The IRS is limited by statute for how long it has to examine a return. Cases close to the statute expiration date are closed without review.

and powers of attorney adhered to applicable laws and regulations. These efforts may have resulted in the decrease in compliance checks completed.

### **Voluntary Compliance Resolution Program**

As part of the Voluntary Compliance Resolution Program, in order to avoid plan disqualification, employers can voluntarily correct operational defects in their retirement plans and obtain approval from the IRS that the corrections are acceptable. Figure 10 shows Program receipts and closures from FY 2015 to FY 2019.

**Figure 10: Number of Voluntary  
Compliance Program Receipts and Closures**



*Source: TIGTA analysis of various internal TE/GE Division and EP data reports.*

From FY 2015 to FY 2019, receipts and closures decreased by nearly 28 and 40 percent, respectively. According to IRS management, through the end of the third quarter FY 2019, several key performance measures had been adversely affected due to fluctuating resources and a backlog in the case building process, which limited the number of cases available for review.

### **Section 3 – Exempt Organizations Function**

The EO function currently oversees approximately 1.76 million tax-exempt entities with varying requirements for tax-exempt status. The EO function has responsibility for:

- Organizations exempt from income tax under Internal Revenue Code (I.R.C.) Section (§) 501 (including private foundations and organizations described in I.R.C. § 170(b)(1)(A), except clause (v)).
- Political organizations described in I.R.C. § 527, and organizations described in I.R.C. § 4947(a).
- Welfare benefit funds described in I.R.C. § 4976.

The EO function accomplishes these responsibilities by processing requests for recognition of tax-exempt status and providing approval or denial determination letters; examining returns to ensure that the exempt organizations meet the statutory requirements for exemption and their

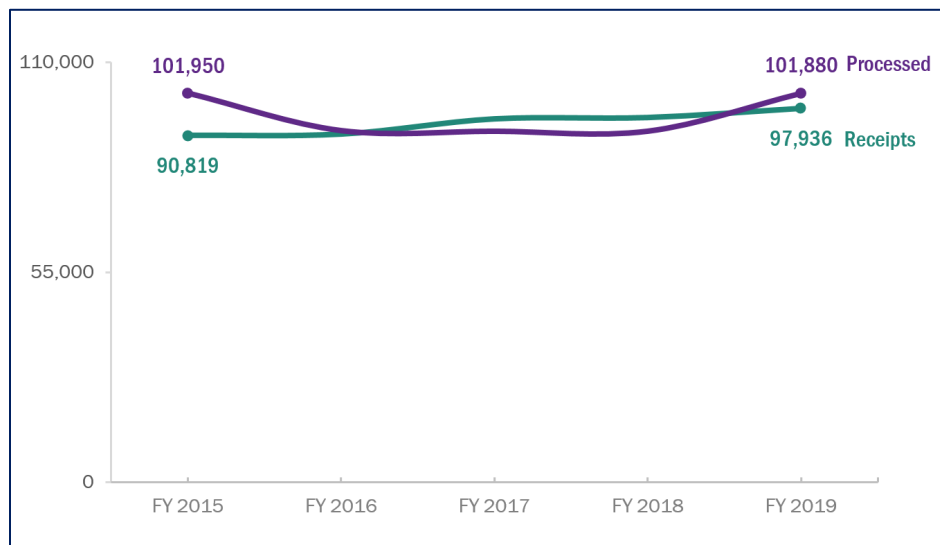


other Federal tax responsibilities, including employment taxes; and coordinating tax administration and enforcement activities with other Federal and State agencies.

## **EO determinations**

Certain types of entities that want to be tax-exempt must apply for a determination from the EO function. Other types of entities can claim tax-exempt status without receiving approval from the IRS. Which application form an entity uses depends on the type and size of the entity.<sup>25</sup> The EO function receives and processes tens of thousands of requests for tax exemption every year. Figure 11 shows the number of requests received and processed during FY 2015 to FY 2019.<sup>26</sup>

**Figure 11: Number of EO Determination  
Letter Requests Received and Processed**



*Source: EP/EO Determination System.*

The EO function, on average, approved approximately 93 percent of all closed applications for tax-exempt status. Management stated that less than 1 percent of closed cases were denied each year, with the remaining closed for other reasons, including applications withdrawn by the applicant before the IRS makes a determination or that did not provide sufficient information to establish that the applicant met the requirements to be recognized as exempt. According to the IRS, the number of denials of initial applications during FY 2015 to FY 2019 is in line with historical numbers. The EO function denies few applications mainly because organizations have not started operations yet and have the ability to change their responses if there is a problem. The IRS works with the organizations to perfect their applications during processing to help them qualify for exemption.

The average number of days to process a determination request fluctuated from year to year, but dropped 12 percent from 192 days to 169 days from FY 2015 to FY 2019. The TE/GE Division temporarily transferred employees from the EO Examinations unit in FY 2019 to

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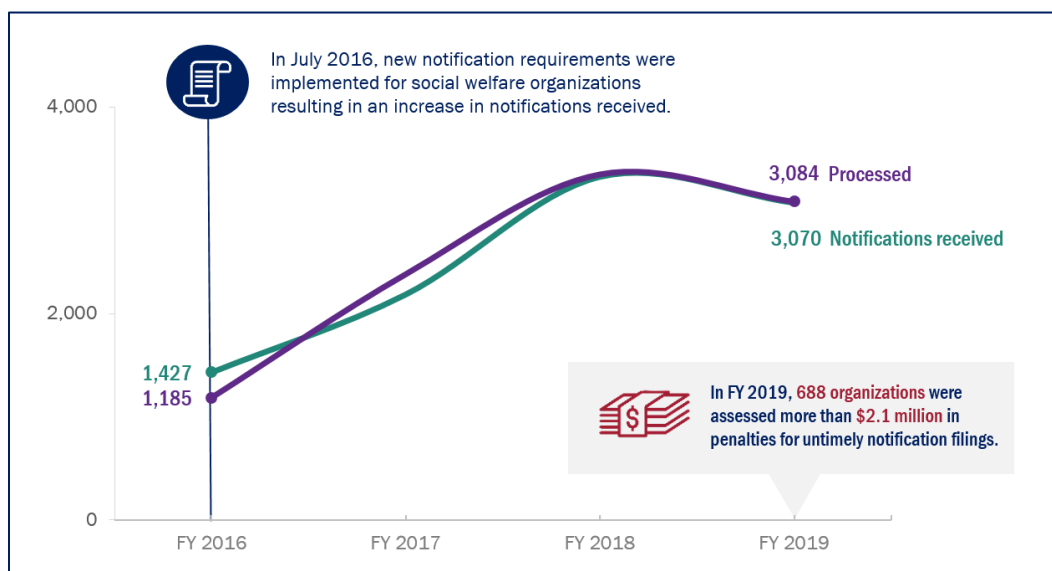
<sup>25</sup> See Appendix II, Figure 4, for a detailed breakdown of the available types of applications for tax-exempt status.

<sup>26</sup> See Appendix II, Figure 5, for a detailed breakdown of the number of EO determination letters requests received and processed by application type.

help process a backlog of determinations requests caused, in part, by the partial Federal Government shutdown.

**Social welfare organizations.** I.R.C. § 501(c)(4) organizations, commonly known as social welfare organizations, are not required to apply for tax-exempt status to operate as a tax-exempt entity. However, on December 18, 2015, the President signed into law the Protecting Americans From Tax Hikes Act of 2015, which requires any newly established social welfare organization to notify the IRS no later than 60 days after the date the organization is established that it is operating as a social welfare organization.<sup>27</sup> The IRS implemented this new filing requirement in July 2016, but did not begin assessing penalties for untimely filings until January 2019. TIGTA recently reported that thousands of organizations may not have filed this notification as required, and the IRS had not taken sufficient actions to identify nonfilers.<sup>28</sup> Figure 12 shows the number of notifications filed and the penalties assessed for untimely filings.

**Figure 12: Number of Notifications Received From New Social Welfare Organizations and Penalties Assessed for Untimely Filings**



*Source: IRS Online Registration System and Returns Inventory Classification System.*

One potential effect of requiring organizations to notify the IRS of their existence is a drop in social welfare organizations filing voluntary applications to receive IRS determinations of their tax-exempt status. From FY 2016 to FY 2019, the number of notifications received from social welfare organizations more than doubled from 1,427 to 3,070 while the number of applications filed for tax-exempt status dropped from 1,872 to 1,566 (approximately 16 percent).<sup>29</sup> This could be an indication that the notice requirement has reduced the number of applications filed by social welfare organizations, creating efficiencies for the EO Determinations unit.

**Exempt organization primary activities.** The National Taxonomy of Exempt Entities codes generally describe the type of organization. These codes are used to identify organizations by primary activity or purpose. The IRS assigns a code to entities filing paper applications that

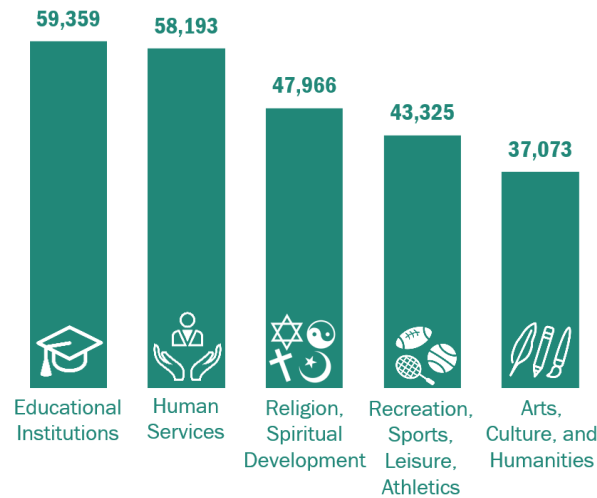
<sup>27</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242.

<sup>28</sup> TIGTA, 2020-10-001, *Many Organizations Are Not Notifying the Internal Revenue Service of Their Intent to Operate Under Internal Revenue Code Section 501(c)(4) As Required by Law*, p. 5 (Jan. 2020).

<sup>29</sup> See Appendix II, Figure 6, for details on EO receipts by I.R.C. subsection.

receive a tax-exempt status determination. However, if the taxpayer files the application electronically, the taxpayer selects a code when completing the application. There has been little change in the types of entities applying for tax-exempt status during FY 2015 to FY 2019. Figure 13 shows the top five primary industries of exempt activities.

**Figure 13: Top Five Primary Industries of Organizations  
Requesting Tax-Exempt Status (FYs 2015 Through 2019 Totals)**



*Source: Analysis of EP/EO Determination System data.*

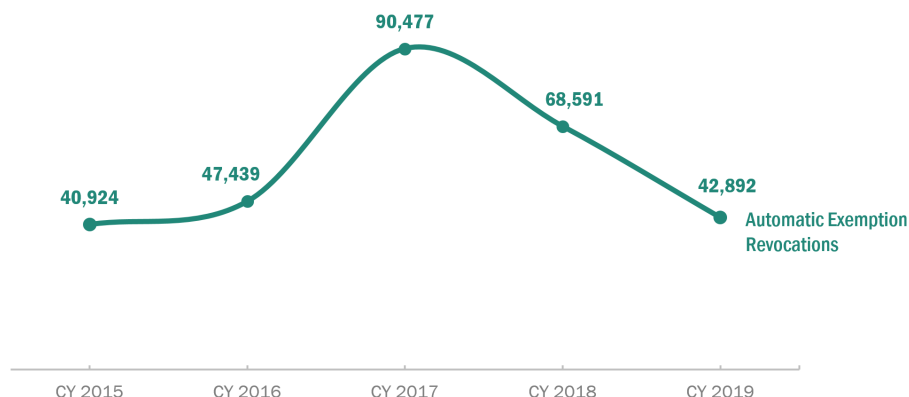
The EO function uses the National Taxonomy of Exempt Entities code when reviewing certain types of applications to ensure that it coincides with the organization's stated mission/activity. In addition, for those applications filed electronically, a computer system uses the code to automatically "grade" the applications, which helps determine how experienced the specialist needs to be in order to process them.

**Automatic exemption revocation for nonfiling.** Automatic revocation of tax-exempt status occurs when an exempt organization that is required to file an annual return or notice does not do so for three consecutive years.<sup>30</sup> An organization otherwise eligible to receive tax-deductible contributions, such as an I.R.C. § 501(c)(3) charity, that loses its tax-exempt status cannot receive tax-deductible contributions. Figure 14 shows that automatic revocations peaked in Calendar Year (CY) 2017 but have since declined.

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<sup>30</sup> Form 990, *Return of Organization Exempt From Income Tax*; Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*; Form 990-PF, *Return of Private Foundation*; and Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990-EZ*.

**Figure 14: Number of Automatic Exemption  
Revocations, CYs 2015 Through 2019**



*Source: IRS Automatic Revocation of Exemption List (Updated Aug. 11, 2020).*

IRS management indicated that the increase in automatic revocations in CYs 2017 and 2018 may have been caused by the IRS's premature establishment of taxpayer accounts between early 2014 and July 2015, whenever an entity applied for an Employer Identification Number and indicated it was a non-profit organization. However, IRS management explained that many of these entities may have never actually established themselves as active tax-exempt organizations. After three years without a return filing, the entities were automatically revoked.

## **E0 annual return filings**

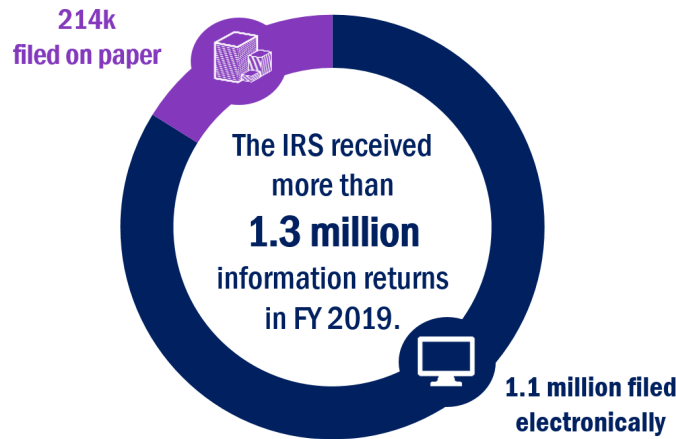
Although tax-exempt organizations do not file annual income tax returns, they are required to file annual information returns or notices.<sup>31</sup> Historically, depending on the size of the organization, filings can be made on paper or electronically. However, as mentioned previously, the Taxpayer First Act now requires all tax-exempt organizations to file their annual information returns electronically beginning with filings due for tax years beginning after July 1, 2019.<sup>32</sup> Figure 15 shows the volume of annual information returns and notices filed in FY 2019 by filing method.<sup>33</sup>

<sup>31</sup> Certain organizations with less than \$50,000 in annual gross receipts file a Form 990-N, rather than a more detailed information return.

<sup>32</sup> For small exempt organizations, the legislation specifically allowed a postponement ("transitional relief") to requiring electronic filing. For tax years ending before July 31, 2021, the IRS will accept either paper or electronic filing of Form 990-EZ. For tax years ending July 31, 2021, and later, Forms 990-EZ must be filed electronically.

<sup>33</sup> See Appendix II, Figure 7, for the number of annual information returns filed during FYs 2015 through 2019.

**Figure 15: Number of Annual Information  
Returns Filed by Filing Method in FY 2019**



*Source: Publication 6292, Fiscal Year Return Projections for the United States.*

Due to the new electronic filing requirement for all annual information returns, the IRS can expect more than 214,000 additional electronic filings beginning in Tax Year (TY) 2020.<sup>34</sup> This may allow employees who currently scan and process paper annual return filings to complete other work.

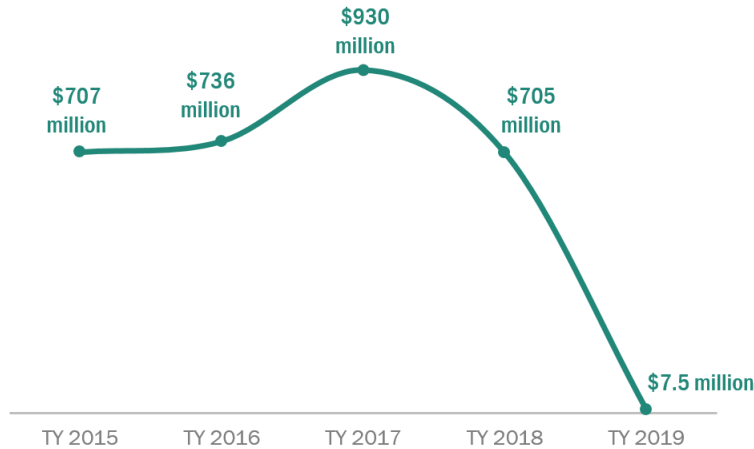
Some tax-exempt organizations also file other types of returns. For example, organizations that have income from activities unrelated to their tax-exempt purpose must file Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*, and pay taxes on this income. The number of Forms 990-T filed during TYs 2015 through 2018 ranged from approximately 167,000 to 205,000, a 23 percent increase; however, for TY 2019, there were only approximately 2,000 filings as of October 2020.<sup>35</sup> IRS management believes the low filing numbers and assessments for TY 2019 is most likely a result of the extended filing due dates implemented because of the Coronavirus disease 2019 pandemic and the delay in processing paper-filed returns. In addition, TIGTA recently reported that EO examiners did not always attempt to identify taxpayers with unrelated business income requirements.<sup>36</sup> Figure 16 shows the taxes associated with these filings.

<sup>34</sup> A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

<sup>35</sup> Total filing numbers and assessment amounts include filed returns with refund requests and returns with assessments paid. See Appendix II, Figure 8, for more details on Form 990-T filings and assessments for FYs 2015 through 2019.

<sup>36</sup> TIGTA, Report No. 2021-30-016, *Emphasis on Unrelated Business Income Tax Enforcement Should Be Enhanced*, p. 4 (Feb. 2021).

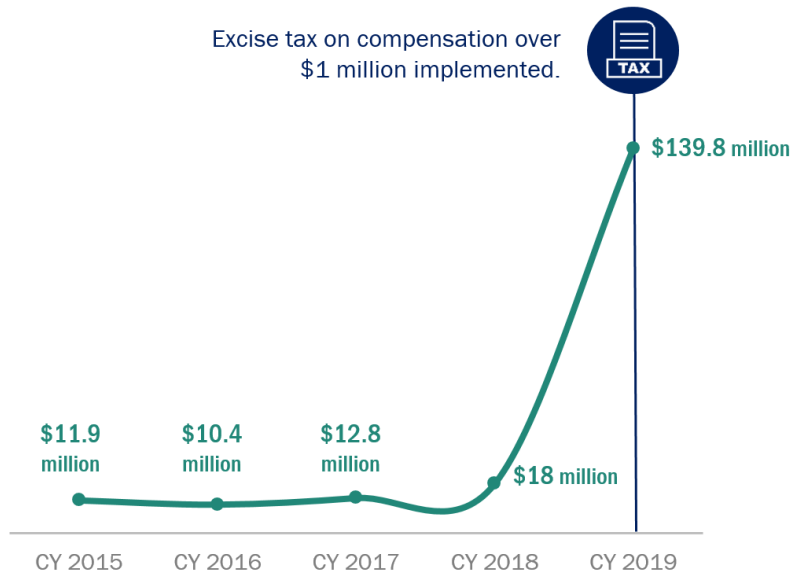
**Figure 16: Amount of Unrelated Business Income Taxes Paid**



Source: Returns Inventory and Classification System.

There are certain excise taxes that tax-exempt organizations may have to pay by filing Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*. As of FY 2019, there are 14 different excise taxes currently reported on Form 4720. The number of Forms 4720 filed during FY 2015 through FY 2019 ranged from approximately 1,750 in CY 2015 to 1,919 in CY 2019. Beginning with TY 2018 returns, organizations must pay an excise tax on compensation over \$1 million to covered employees, which likely contributed to the increased amount of excise taxes collected in CY 2019.<sup>37</sup> Figure 17 shows the taxes associated with these filings.

**Figure 17: Amount of Excise Taxes Paid**



Source: Statistics of Income Tax Statistics.

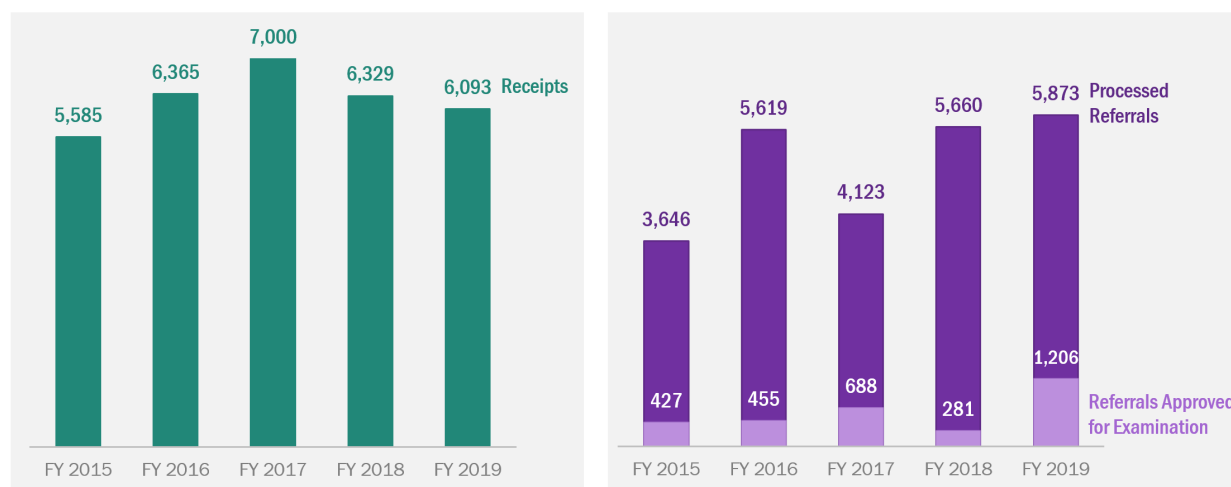
<sup>37</sup> A covered employee is any current or former employee who is one of the five highest compensated employees of the organization (regardless of income amount) for any taxable year beginning after December 31, 2016.

In June 2019, TIGTA reported that although the TE/GE Division coordinated with other IRS offices and developed an action plan that identified the steps needed for the implementation of the excise tax provision on compensation over \$1 million, management did not complete a strategy to address noncompliance with the new tax.<sup>38</sup> Since TIGTA's report, however, IRS management stated that they developed a strategy to address noncompliance with the excise tax on compensation exceeding \$1 million. In April 2019, an educational letter was issued to organizations that the IRS identified as being subject to the excise tax, which included a link to a website with more information. The TE/GE Division captured and analyzed data of organizations' access to this website and, as a result, is currently evaluating an enforcement compliance strategy. TIGTA plans to conduct a future audit related to the implementation and enforcement of this new excise tax requirement.

## EO referrals

The CP&C function identifies EO returns for examinations using various sources, like data analytics of return information. Another source is referrals received from within the IRS (internal; *i.e.*, other IRS business units) or outside the IRS (external; *e.g.*, taxpayers, members of Congress).<sup>39</sup> Figure 18 shows the number of referrals received and processed for the EO function.

**Figure 18: Number of Referrals Received and Processed for the EO Function**



Source: EO Referral Database and Reporting Compliance Case Management System (FY 2015) and Reporting Compliance Case Management System (FYs 2016 through 2019).

The number of referrals processed fluctuated from FY 2015 to FY 2019, but ultimately increased by 61 percent. TIGTA believes a possible reason for the drop in referrals processed in FY 2017 may be due to the CP&C function transition. Figure 19 shows the results of the examinations from referrals and whether the case was identified from internal or external sources.

<sup>38</sup> TIGTA, Report No. 2019-14-032, *Tax Cuts and Jobs Act: Assessment of Implementation Planning Efforts for the Excise Tax on Excess Compensation Paid by Tax-Exempt Organizations*, pp. 5, 7 (June 2019).

<sup>39</sup> A referral is any communication (information/knowledge) from the public or a Federal or State regulatory agency about potential noncompliance by an exempt organization.

**Figure 19: Results of EO Examinations Identified From Referrals**

|   | FY 2015      | FY 2016    | FY 2017    | FY 2018    | FY 2019    |
|---|--------------|------------|------------|------------|------------|
| <b>Total EO Closed Examinations</b>         | <b>1,250</b> | <b>886</b> | <b>770</b> | <b>553</b> | <b>325</b> |
| Internal Referrals                          | 677          | 356        | 372        | 370        | 193        |
| External Referrals                          | 570          | 530        | 398        | 183        | 132        |
| Unknown Referrals                           | 3            | 0          | 0          | 0          | 0          |
| Percentage of Examinations Closed No Change | 20%          | 20%        | 24%        | 22%        | 21%        |
| <b>Total EO Non-Examined Closures</b>       | <b>323</b>   | <b>390</b> | <b>300</b> | <b>256</b> | <b>150</b> |
| Internal Referrals                          | 72           | 159        | 65         | 170        | 71         |
| External Referrals                          | 251          | 229        | 235        | 86         | 79         |
| Unknown Referrals                           | 0            | 2          | 0          | 0          | 0          |

*Source: Returns Inventory and Classification System.*

From FY 2015 to FY 2019, total EO examinations identified from referrals decreased from 1,250 to 325. TIGTA believes that this decrease is a result of changing priorities in case selection. For example, in FY 2018, the TE/GE Division began prioritizing compliance strategy cases before referral cases. On average, closed referral examinations resulted in no changes approximately 21 percent of the time for the period FY 2015 through FY 2019.

## EO examinations

The EO Examinations unit reviews returns to determine if tax-exempt organizations comply with tax laws and qualify for tax-exempt status. Continuing qualification requires the organizations to conduct activities related to their approved tax-exempt purposes. TIGTA recently reported that the EO function faces many obstacles when detecting noncompliant activity, but generally has the information necessary to detect it during an examination.<sup>40</sup> Figure 20 shows a decline in the number of EO examinations completed from FY 2015 through FY 2019.

**Figure 20: Number of EO Examinations and Non-Examined Closures**

|                                   | FY 2015      | FY 2016      | FY 2017      | FY 2018      | FY 2019      |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>Total Examination Closures</b> | <b>6,392</b> | <b>6,440</b> | <b>6,101</b> | <b>4,891</b> | <b>3,675</b> |
| Total Change Cases                | 5,233        | 5,244        | 5,010        | 4,125        | 3,181        |
| Total No Change Cases             | 1,159        | 1,196        | 1,091        | 766          | 494          |
| Percentage No Change              | 18%          | 19%          | 18%          | 16%          | 13%          |
| <b>Total Non-Examined</b>         | <b>1,737</b> | <b>1,777</b> | <b>1,452</b> | <b>1,237</b> | <b>900</b>   |

*Source: Returns Inventory and Classification System.*

The number of examinations declined by 43 percent from FY 2015 to FY 2019, mainly due to the temporary reassignment of examiners to the EO Determinations unit and the CP&C function's Classification unit to assist with processing backlogs of inventory. However, the percentage of

<sup>40</sup> TIGTA, Report No. 2021-10-013, *Obstacles Exist in Detecting Noncompliance of Tax-Exempt Organizations*, pp. 4, 10 (Feb. 2021).



closures resulting in no changes has favorably dropped from 18 percent to 13 percent and the number of non-examined closures has declined by 48 percent indicating that the selection of productive cases has improved.

The Government Accountability Office recently completed a review of the EO function's use of data to identify examination workload and found that the models that the IRS uses to score returns for potential noncompliance did not improve change rates compared to prior selection methods, and a higher model score is not associated with a higher change rate.<sup>41</sup>

## EO compliance checks

Figure 21 shows the number and results of compliance checks, which are non-examination reviews to determine whether specific items have been reported properly, completed by the EO function, as well as those completed for the EO by the TECU.

**Figure 21: Number of EO Function Compliance  
Checks Completed, Referred, and Examined**

|   | FY 2015      | FY 2016      | FY 2017      | FY 2018      | FY 2019      |
|---|--------------|--------------|--------------|--------------|--------------|
| <b>Total Compliance Check Closures</b>  | <b>1,887</b> | <b>1,687</b> | <b>1,289</b> | <b>1,244</b> | <b>3,116</b> |
| Total Referred for Possible Examination | 165          | 98           | 14           | 3            | 40           |
| Total Selected for Examination          | 165          | 98           | 14           | 3            | 8            |
| <b>Total Surveyed Cases</b>             | <b>0</b>     | <b>0</b>     | <b>0</b>     | <b>1</b>     | <b>3</b>     |
|   |              |              |              |              |              |
| <b>Total Examinations</b>               | <b>165</b>   | <b>98</b>    | <b>14</b>    | <b>2</b>     | <b>5</b>     |
| Total No Change Examinations            | 35           | 11           | 0            | 1            | 0            |
| Total Change Examinations               | 130          | 87           | 14           | 1            | 5            |

*Source: Exempt Organization Compliance Unit Database (FYs 2015 to 2017); Exempt Organization Compliance Unit Database and Reporting Compliance Case Management System (FY 2018); and Returns Inventory Classification System (FY 2019).*

The number of completed compliance checks rose by 65 percent from FY 2015 to FY 2019. According to IRS management, the main reason for this increase was the creation of the TECU, which completed more than 1,600 (53 percent) of the total EO compliance checks in FY 2019. This Unit allows the TE/GE Division to complete more compliance check workload and increase its presence in the tax-exempt community. The TECU also makes examination referrals to the EO based on this work.

## Tax-exempt hospital reviews

Enacted on March 23, 2010, the Patient Protection and Affordable Care Act imposed additional requirements for hospital organizations to qualify for tax exemption and required them to

<sup>41</sup> Government Accountability Office, GAO-20-454, *Tax Exempt Organizations: IRS Increasingly Uses Data in Examination Selection, but Could Further Improve Selection Processes*, p. 13 (June 2020).

complete a community health needs assessment once every three years.<sup>42</sup> As mandated by the Act, the CP&C function reviews hospitals for compliance with the Act requirements, including the community health needs assessments, on a triennial basis. The CP&C function identifies the universe of applicable organizations at the beginning of a three-year period and divides them up into three groups for review, one group each year. Figure 22 shows the number and results of hospital reviews completed during FYs 2015 through 2019.

**Figure 22: Number and Results of Tax-Exempt Hospital Reviews<sup>43</sup>**

|                          | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|--------------------------|---------|---------|---------|---------|---------|
| Closed Reviews           | 813     | 968     | 1,193   | 988     | 750     |
| Referred for Examination | 52      | 339     | 388     | 131     | 49      |
| Approved for Examination | 41      | 264     | 168     | 72      | 7       |
| Surveyed Closures        | 1       | 32      | 19      | 4       | 0       |
|                          |         |         |         |         |         |
| Closed Examinations      | 100     | 278     | 158     | 66      | 1       |
| No Change Closures       | 26      | 89      | 43      | 17      | 0       |
| Change Closures          | 74      | 189     | 115     | 49      | 1       |

*Source: Reporting Compliance Case Management System and Returns Inventory and Classification System.*

Overall, the number of tax-exempt hospital reviews that resulted in an examination has declined significantly since FY 2015. The IRS indicated that because the universe of hospitals is reviewed every three years, at this point, most hospitals have undergone three or four reviews and have become more compliant over time. Hospitals have also become more familiar with the requirements and implemented corrections from previous examinations. In addition, during FY 2018, there was a change to the EO function's case review process in which specific types of deficiencies were sent for a compliance check instead of an examination, which may have resulted in the decrease in examinations from FY 2018 to FY 2019.

In September 2020, the Government Accountability Office reported that although nonprofit community hospitals can be tax-exempt if they provide community benefits and meet legal requirements, it is difficult for the IRS to verify community benefits because the law is not specific about which services qualify.<sup>44</sup> Further, the IRS does not have authority to specify activities hospitals must undertake and therefore makes determinations based on the facts and circumstances of each case.

<sup>42</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of 26 and 42 U.S.C.), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

<sup>43</sup> Some examinations span across more than one fiscal year, so total referred and total closed examinations may not equal in any given year.

<sup>44</sup> Government Accountability Office, GAO-20-679, *Tax Administration: Opportunities Exist to Improve Oversight of Hospitals' Tax-Exempt Status*, p. 12 (Sept. 2020).

## **Section 4 – Federal, State, and Local (Governments)/Employment Tax Function**

The FSL/ET function has oversight responsibility for Federal tax compliance by Federal, quasi-governmental and State agencies; city, county, and other units of local government; as well as American Samoa, Guam, Puerto Rico, and the U.S. Virgin Islands.<sup>45</sup> The FSL/ET function accomplishes these responsibilities by operating voluntary compliance programs and entering into closing agreements, developing national education and outreach programs, examining returns, and coordinating with the Department of Justice on litigation issues.

Further, the FSL/ET function's employment tax specialists conduct examinations and participate in outreach events with their government entity customers who employ approximately 23 million employees, which is about 20 percent of the entire American workforce. Government entities pay wages of more than \$760 billion annually and pay employment taxes in excess of \$200 billion a year. This sector is the largest block of employees in the Nation. As of CY 2017, the U.S. Census Bureau reported that there are over 90,000 unique State and local governments in the United States.<sup>46</sup>

### **FSL/ET annual filings**

Government entities are required to file Form 941, *Employer's Quarterly Federal Tax Return*, quarterly to report employment wages subject to Federal income tax withholding or Social Security and Medicare taxes. Per available data, approximately 77,000 Forms 941 are filed each year by Federal, State, and local governments. Federal entities made up an average of 0.4 percent of all FSL/ET customers filing Forms 941 from FY 2015 to FY 2019.

### **FSL/ET referrals**

The FSL/ET function receives referrals of potential noncompliance from internal and external sources. The number of referrals received and processed for FYs 2015 through 2017 was not available, so we could not report this information. Prior to FY 2018, referral data were maintained in a database accessed by FSL/ET employees who have since retired and the data no longer exist. For FYs 2018 and 2019, the number of referrals received increased from 46 referrals to 399 referrals, a 767 percent increase. IRS management stated that this spike was due to a change in how the TECU processes non-responder cases.<sup>47</sup> For FYs 2018 and 2019, the number of referrals closed were 57 and seven, respectively, and only nine and one were referred to examination in those respective years. According to IRS management, although the FSL/ET function received a large number of referrals from the TECU in FY 2019, very few of the referrals warranted examination, so the majority were closed without further review. In addition, according to IRS officials, the CP&C function lacked adequate staff in FYs 2018 and 2019 for classifying referrals. Instead, priority was given to classifying compliance strategy cases, claims,

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<sup>45</sup> See Appendix II, Figure 9, for Federal, State, and local entity definitions.

<sup>46</sup> U.S. Census Bureau, *2017 Census of Governments: Organization Component Estimates*, (2019). The Census Bureau conducts the Census of Governments every five years, in years ending with a "2" and "7."

<sup>47</sup> According to the IRS, a non-responder case involves a taxpayer who has not responded to an IRS inquiry. In October 2018, the TECU began processing compliance checks. Procedures required that if an IRS inquiry was sent to a taxpayer but a response was never received, the case should be referred as a potential examination.

and other work, while the backlog of referrals was allowed to age because very few yielded productive examination work.

Figure 23 shows the results of the examinations from referrals, and whether the cases originated from internal or external sources.

**Figure 23: Results of FSL/ET Examinations Identified From Referrals**

|   | FY 2015   | FY 2016    | FY 2017    | FY 2018    | FY 2019   |
|---|-----------|------------|------------|------------|-----------|
| <b>Total FSL/ET Closed Examinations</b>     | <b>74</b> | <b>101</b> | <b>129</b> | <b>121</b> | <b>28</b> |
| Internal Referrals                          | 19        | 12         | 20         | 20         | 4         |
| External Referrals                          | 55        | 89         | 109        | 101        | 24        |
| Percentage of Examinations Closed No Change | 9%        | 8%         | 19%        | 17%        | 14%       |
| <b>Total FSL/ET Non-Examined Closures</b>   | <b>4</b>  | <b>11</b>  | <b>16</b>  | <b>28</b>  | <b>0</b>  |
| Internal Referrals                          | 0         | 2          | 8          | 12         | 0         |
| External Referrals                          | 4         | 9          | 8          | 16         | 0         |

*Source: Returns Inventory and Classification System.*

Overall, the majority of FSL/ET function referrals that were examined came from external sources, and examiners closed them without changes, on average, 13 percent of the time for the period FY 2015 to FY 2019. When the FSL/ET function transitioned from a standalone organization to part of the EO function and referral processing was moved to the CP&C function, the entire referral process changed. Although they cannot say with certainty, IRS management believes that the spikes in the percentage of examinations closed without changes in FYs 2017 and 2018 were caused by a substantial learning curve for CP&C function classifiers, who were previously not confronted with identifying potential FSL/ET function issues. As a result, referrals were of low quality and could have been non-examined instead.

In addition, the non-examined closures increased from FY 2015 to FY 2018, but dropped to zero in FY 2019. According to IRS management, all returns are examined based on the facts and circumstances of each case. Data on which referrals are based are often from a year or more in the past. A potential noncompliance issue may or may not be present in the subsequent year requiring an examination. In addition, sometimes information is available during pre-audit planning that indicates that there are no large, unusual, or questionable items; and in these cases, the returns are surveyed (non-examined). Management stated that changes in the number of non-examined closures from one year to the next are merely coincidental.

## **FSL/ET examinations**

The FSL/ET examinations program mainly focuses on reviewing employment tax compliance. For FYs 2015 to 2019, the majority of FSL/ET examinations were completed on municipalities, counties, and schools, making up 68 percent of all closures during FY 2015 to FY 2019.<sup>48</sup> Only about 3 percent of the closed examinations were for Federal agencies and of those, approximately 40 percent were closed without changes. In addition, issues related to employee

<sup>48</sup> See Appendix II, Figure 10, for more details on the number of closed examination returns and change results by entity type.

classification,<sup>49</sup> unreported compensation, and taxable fringe benefits<sup>50</sup> were the most common reasons for an examination.<sup>51</sup> Figure 24 shows the number of FSL/ET examinations and non-examined closures.

**Figure 24: Number of FSL/ET Examinations and Non-Examined Closures**

|                                   | FY 2015      | FY 2016      | FY 2017      | FY 2018      | FY 2019      |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>Total Examination Closures</b> | <b>1,998</b> | <b>1,872</b> | <b>1,612</b> | <b>1,687</b> | <b>1,349</b> |
| Total Change Cases                | 1,841        | 1,674        | 1,460        | 1,362        | 1,162        |
| Total No Change Cases             | 157          | 198          | 152          | 325          | 187          |
| Percentage No Change              | 8%           | 11%          | 9%           | 19%          | 14%          |
| <b>Total Non-Examined</b>         | <b>364</b>   | <b>1,435</b> | <b>783</b>   | <b>1,542</b> | <b>488</b>   |

*Source: Returns Inventory and Classification System.*

Overall, examination closures decreased by about 32 percent from FY 2015 to FY 2019. According to IRS management, several factors may have contributed to this decrease.

- The FSL/ET function experienced more than a 50 percent decrease in staffing during this period.
- In FY 2016, IRS management made a decision to examine a higher number of large entities (governments with at least \$40 million in annual wages), which generally have more complex payroll issues, a higher risk for substantial noncompliance, and usually take longer to complete.
- In FYs 2018 and 2019, a compliance strategy reduced the number of returns examined by requiring review of Forms 945, *Annual Return of Withheld Federal Income Tax*, instead of Forms 941. This change resulted in one primary return per case to close instead of four primary returns per case to close.
- Due to the partial Federal Government shutdown, FY 2019 included a one-month furlough that affected closure totals.

**Examination no change closures.** The number of no change closures increased by 19 percent from FY 2015 to FY 2019, indicating that the productiveness of returns identified for examination has declined over the years. The IRS offered several potential reasons for this increase including:

- A high volume of returns was selected for examination prior to the implementation of a new classification process in order to maintain available inventory during the transition period. These returns were selected in bulk, in a short period of time, by less experienced classifiers. In addition, there was no ranking or priority assigned to the cases, which were randomly pulled and assigned to examiners so they may not have been the most productive cases available.

<sup>49</sup> Employee classification issues refer to determining whether someone is an employee or independent contractor.

<sup>50</sup> A fringe benefit is a form of pay for the performance of services. For example, an employer provides a fringe benefit when the employer allows an employee to use a business vehicle to commute to and from work. Fringe benefits are taxable and must be included in the recipient's pay unless the law specifically excludes it.

<sup>51</sup> See Appendix II, Figure 11, for more details on the number of closed examinations by principal issue for FYs 2015 through 2019.

- Other factors, such as experienced staff retiring, may have contributed to the high rate of examinations closed without changes.

Further, IRS management believes the lower no change rate for FY 2019 may have resulted from a better selection of returns for examination due to surveying prior year returns for noncompliance issues and selecting returns in small batches based on inventory needs.

**Non-examined closures.** Overall, non-examined closures increased by 34 percent from FY 2015 to FY 2019. IRS leadership could not say with certainty why there were spikes in non-examined closures for the period FY 2016 through FY 2018, as the employees involved in classifying cases have since retired, but management speculated that a high volume of returns was selected to maintain inventory during the implementation of a new classification process. However, not all cases could be worked and were closed without review due to expiring statutes of limitations (*i.e.*, time allowed by law for the IRS to examine a return).

### **FSL/ET compliance checks**

During FYs 2015 through 2019, compliance checks were conducted by the FSL/ET function, the TECU, and the Government Entities Compliance Unit.<sup>52</sup> The FSL/ET function stopped completing compliance checks in FY 2015. Figure 25 shows the number and results of compliance checks completed.

**Figure 25: FSL/ET Compliance Checks**

|                                  | FY 2015                 | FY 2016    | FY 2017    | FY 2018   | FY 2019 <sup>53</sup> |
|----------------------------------|-------------------------|------------|------------|-----------|-----------------------|
| <b>Compliance Check Closures</b> | <b>697<sup>54</sup></b> | <b>215</b> | <b>480</b> | <b>56</b> | <b>2,657</b>          |
| No Change                        |                         | 84         | 175        | 6         | 1,214                 |
| Change                           |                         | 131        | 305        | 50        | 1,443                 |

*Source: Reporting Compliance Case Management System and the Government Entities Base Inventory Master File table.*

IRS management was unable to explain the decrease of FSL/ET function-related compliance check closures from FY 2017 to FY 2018. The number of compliance checks increased by 4,645 percent from FY 2018 to FY 2019, which coincides with the establishment of the TECU. According to TECU officials, the large number of no change cases in FY 2019 was due to cases sitting in inventory for a long time and, after assignment of the cases to the TECU, a large percentage of those cases no longer included noncompliant issues. In addition, no compliance check cases were referred for possible examination during FYs 2015 through 2019.

<sup>52</sup> The Government Entities Compliance Unit is part of the TEB Program Office comprised of tax compliance officers who process various FSL/ET, ITG, and TEB compliance strategies and compliance checks via correspondence examination.

<sup>53</sup> FY 2019 FSL/ET function figures include a compliance check project involving both FSL/ET and EO function taxpayers.

<sup>54</sup> According to the IRS, the FY 2015 compliance check closures were closed using erroneous disposal codes that do not indicate change or no change, and it currently does not have any information on why erroneous codes were applied. However, the IRS confirmed that the FSL/ET function did not refer any compliance checks for examination.

## **Section 5 – Indian Tribal Governments Function**

The ITG function has responsibility for maintaining a functional and interactive government-to-government relationship between the IRS and Indian tribal governments. It accomplishes this by operating voluntary correction programs and entering into closing agreements, developing national education and outreach programs, examining returns, and coordinating with other IRS divisions on matters related to tribal members, benefits, and entities.

As of January 2020, there were 574 Federally recognized Indian tribes as well as over 2,500 tribal entities. Tribal businesses are diverse and include industries such as gaming, aerospace, banking, and healthcare, among others.

According to IRS officials, there are 241 gaming tribes across 29 States that make up 520 gaming establishments. Gross gaming revenue for tribal casinos was \$33.7 billion in FY 2018; by comparison, gross gaming revenue of commercial casinos in FY 2018 was \$41.7 billion. The tribal gaming industry employs 300,000 employees, half of which are Indian individuals. The ITG function has 214 tip agreements, subsequently discussed, covering 332 establishments.

### **ITG annual filings**

Generally, Indian tribes in their role as employers are subject to Federal employment tax laws and procedures. Per available data, approximately 200 Forms 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, are filed each year by tribes or one of their sub-divisions, instrumentalities, or wholly owned subsidiaries.<sup>55</sup>

### **ITG referrals**

The number of referrals of potential noncompliance from internal and external sources received and processed for FYs 2015 through FY 2017 was not available, so we could not report this information. For FYs 2018 and 2019, the number of referrals received increased from seven to 21 referrals, and the number of referrals processed were five and 15, respectively. The IRS receives few ITG function referrals that result in examinations, and the majority of ITG function referrals examined come from internal sources.

### **ITG examinations**

As part of its overall responsibility for Federal tax administration involving Federally-recognized Indian tribes, the ITG function conducts examinations to determine Federal tax liabilities and filing requirements. This is part of its balanced approach to improve compliance, combined with outreach, education, and compliance checks. Figure 26 shows the number of closed ITG function examinations.

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<sup>55</sup> The Form 940 is used to report a taxpayer's annual Federal Unemployment Tax Act tax. Together with State unemployment tax systems, the Federal Unemployment Tax Act tax provides funds for paying unemployment compensation to workers who have lost their jobs.



**Figure 26: Number of ITG Examinations and Non-Examined Closures**

|                                   | FY 2015    | FY 2016    | FY 2017    | FY 2018    | FY 2019    |
|-----------------------------------|------------|------------|------------|------------|------------|
| <b>Total Examination Closures</b> | <b>182</b> | <b>276</b> | <b>191</b> | <b>128</b> | <b>200</b> |
| Total Change Cases                | 165        | 214        | 173        | 109        | 140        |
| Total No Change Cases             | 17         | 62         | 18         | 19         | 60         |
| Percentage No Change              | 9%         | 22%        | 9%         | 15%        | 30%        |
| <b>Total Non-Examined</b>         | <b>27</b>  | <b>12</b>  | <b>36</b>  | <b>17</b>  | <b>62</b>  |

*Source: Data reported from ITG internal database (FYs 2015 through 2017), Reporting Compliance Case Management System (FYs 2018 and 2019), Returns Inventory and Classification System, and Audit Information Management System (FY 2019).*

During FYs 2015 through FY 2019, the number of ITG examination closures ranged from 128 to 276, with fluctuations caused by the following factors.

In September 2014, the *Tribal General Welfare Exclusion Act of 2014* was signed into law, which excludes certain types of payments made or service provided to, or on behalf of, a member of an Indian tribe (or a spouse or dependent of a member) under an Indian tribal government program from income for tax purposes.<sup>56</sup> The Act also suspends all examinations related to the exclusion of a payment or benefit under the general welfare exclusion until the Act's required education and training of IRS field agents and certain Indian tribal members are completed. IRS leadership stated that this education and training is in process, so any potential issues with general welfare exclusions are not being examined. Also, FY 2017 examination closures were affected by implementation of a TE/GE Division-wide "next best case" work plan that identified fewer ITG function examinations and compliance checks.<sup>57</sup>

The ITG function closed 977 examinations for the period FY 2015 to FY 2019; approximately 3 percent of which came from internal and external referrals. Overall, the internal and external referral examinations resulted in only 2 percent of the change closures from FY 2015 through FY 2019.

### **ITG compliance checks**

The ITG function also conducts compliance checks, which are non-examination reviews to determine whether specific items have been reported properly. Figure 27 shows the number and results of compliance checks completed by the ITG function.

<sup>56</sup> Pub. L. No. 113-168, 128 Stat. 1883.

<sup>57</sup> Selecting cases that have the highest risk of noncompliance is referred to as selecting the "next best case."



**Figure 27: ITG Compliance Checks**

|  | FY 2015    | FY 2016    | FY 2017   | FY 2018    | FY 2019  |
|--|------------|------------|-----------|------------|----------|
| <b>Total Compliance Check Closures</b> | <b>230</b> | <b>125</b> | <b>47</b> | <b>100</b> | <b>1</b> |
| Total No Change                        | 66         | 49         | 23        | 46         | 1        |
| Total Change                           | 164        | 76         | 24        | 54         | 0        |

*Source: ITG Inventory and Classification Database (FYs 2015 and 2016) and Reporting Compliance Case Management System (FYs 2017 through 2019).*

The number of compliance checks conducted fluctuated from a high of 230 to a low of one during FYs 2015 through 2019, and no compliance check cases were referred for possible examination. The fluctuation in closures is due to changes in the ITG function's work plan. According to IRS management, changes to workload priorities resulted in the ITG function no longer performing certain types of compliance checks, as examinations and tip agreement reviews were prioritized. Thus, compliance checks likely dropped due to a combination of workload prioritization and the ITG function not having capacity to take on additional compliance checks.

### **Tip agreements**

The ITG function, in conjunction with the IRS's Small Business/Self-Employed Division's National Tip Reporting Compliance Program, uses voluntary Gaming Industry Tip Compliance Agreements as part of its tribal oversight. These agreements promote compliance with the provisions of the I.R.C. relating to tip income by gaming industry employers and employees. Under the Program, a gaming industry employer and the IRS work together to reach an agreement that establishes minimum tip rates for tipped employees in specified occupational categories, prescribes a threshold level of participation by the employer's employees, and reduces compliance burdens for the employer and enforcement burdens for the IRS.

There are several processes involved in the Gaming Industry Tip Compliance Agreements program. IRS employees may solicit tribes to enter into a tip agreement. In addition, a tip rate review examines how the rates were determined and the related internal and accounting controls. Further, tip compliance involves conducting follow-up reviews of the employer's compliance with the tip agreement. Finally, tribes may also submit addendums to their tip agreements. Figure 28 includes statistics related to this voluntary program.

**Figure 28: ITG Tip Agreements**

| Type of Agreement           | FY 2015   | FY 2016    | FY 2017    | FY 2018    | FY 2019   |
|-----------------------------|-----------|------------|------------|------------|-----------|
| Solicitations               | 9         | 11         | 15         | 23         | 14        |
| Tip Rate Review             | 37        | 65         | 64         | 61         | 51        |
| Addendum/Customer Initiated | 14        | 18         | 12         | 12         | 19        |
| Tip Compliance              | 0         | 23         | 17         | 10         | 15        |
| <b>Total</b>                | <b>60</b> | <b>117</b> | <b>108</b> | <b>106</b> | <b>99</b> |

*Source: Data reported from ITG internal database (FYs 2015 through 2017) and Reporting Compliance Case Management System (FYs 2018 and 2019).*

The number of tip rate reviews increased by 38 percent from FY 2015 to FY 2019. In addition, tip compliance reviews were first piloted in FY 2015 by the IRS and later introduced as a new work type in FY 2016. Solicitations by the ITG function for tip agreements varied during FY 2015 through FY 2019 because tip rate reviews are given priority in the work plan.

### **ITG outreach efforts**

While the IRS has enforcement authority, it is the ITG function's objective to build coalitions with tribes to mitigate the need for enforcement by combining its compliance and enforcement initiatives with outreach and education (O&E) activities. O&E activities help to increase voluntary compliance by helping ITG function customers understand how they can accurately and timely file required returns.

During FYs 2015 through 2019, there were 147 unique O&E offerings provided in live presentations and online. The most frequent topic covered was on Bank Secrecy Act (Title 31) issues.<sup>58</sup> ITG function O&E efforts reached an estimated 20,000 taxpayers during FY 2015 through FY 2019. TIGTA recently determined that the ITG function could improve oversight and accountability for its O&E activities because it does not effectively track and report them.<sup>59</sup>

## **Section 6 – Tax-Exempt Bonds Function**

The TEB function's mission is to work with stakeholders in the tax-exempt bond community to encourage and achieve the highest degree of voluntary compliance with the law. It accomplishes this by operating voluntary correction programs and entering into closing agreements, developing national education and outreach programs, examining returns, and coordinating with the Securities and Exchange Commission and other Federal and State agencies.

In CY 2019, the municipal bond market was a \$3.9 trillion capital market consisting of nearly 96,000 unique issuers, in which 57 percent of bonds were issued by cities, 26 percent by

<sup>58</sup> The Bank Secrecy Act (Title 31) includes the first laws passed to fight money laundering in the United States. Part of the ITG function's responsibilities include educating Indian tribal governments on the Bank Secrecy Act requirements.

<sup>59</sup> TIGTA, Audit # 202010013, *Review of the Indian Tribal Government Office's Compliance Program*. TIGTA also identified improvements that could be made to TE/GE Division performance measures and an internal control environment that could increase risks.

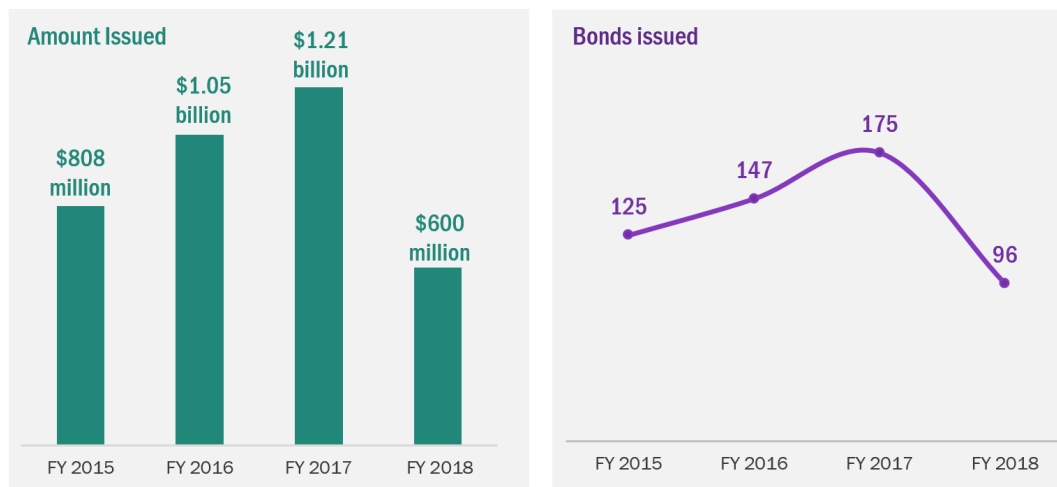
counties, 14 percent by other municipalities, and 4 percent by States.<sup>60</sup> Municipal bonds finance two-thirds of the infrastructure projects in the United States.

### Initial bond filings

The IRS receives filings from bond issuers notifying it of a new bond issuance. During FYs 2015 through 2019, the IRS received more than 186,000 initial bond filings totaling more than \$2.8 trillion for 36 different market segments.<sup>61</sup> The top five market segments or bond issuance types were Other, Education, Lease, Utilities, and Public Safety.<sup>62</sup> Once this initial bond filing is made, there are no other annual filings required.

There are two main types of bonds – tax credit and tax-exempt.<sup>63</sup> Starting in CY 2018, tax credit bonds were no longer allowed per a legislative change, so the data presented for FY 2018 do not represent an entire years' worth of filings.<sup>64</sup> Figure 29 shows the total dollar amounts and number of tax credit bond issuances increased steadily from FY 2015 to FY 2017 and then dropped in FY 2018 when the bonds were eliminated. The number of new bond issuances increased by 40 percent from FY 2015 to FY 2017.

**Figure 29: Total Dollar Amount and Number of Tax Credit Bond Issuances**



Source: Returns Inventory and Classification System.

<sup>60</sup> Unique issuers identified using data accessed in August 2019 at <https://emma.msrb.org/IssuerHomePage>.

<sup>61</sup> Filing statistics comprise Form 8038, *Information Return for Tax-Exempt Private Activity Bond Issues*, Form 8038-G, *Information Return for Tax-Exempt Governmental Bonds*, Form 8038-GC, *Information Return for Small Tax-Exempt Governmental Bond Issues, Leases, and Installment Sales*, and Form 8038-TC, *Information Return for Tax Credit Bonds and Specified Tax Credit Bonds* data for FYs 2015 through 2019.

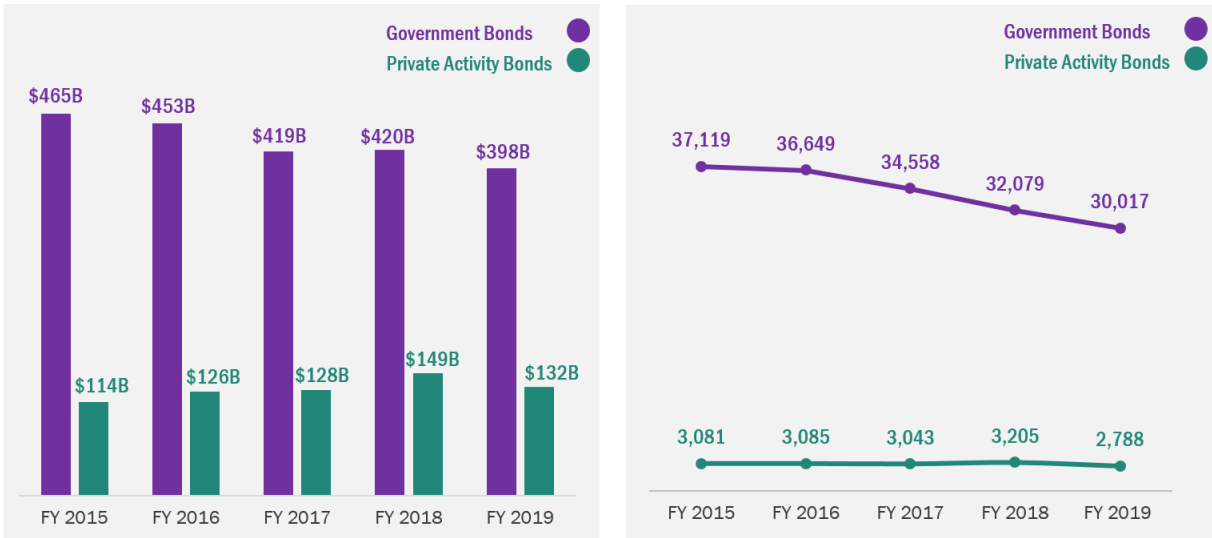
<sup>62</sup> The Other category consists of other types of financings such as parks, hotels, convention centers, and stadiums. See Appendix II, Figure 12, for the number of returns and total dollar amounts of the top five market segments.

<sup>63</sup> Generally, a tax credit bond is an obligation that entitles the taxpayer holding such bond to a credit against the Federal income tax imposed for that tax year. Tax-exempt bonds are valid debt obligations of State and local governments, the interest on which is tax-exempt. This means that the interest paid to bondholders is not includable in their gross income for Federal income tax purposes.

<sup>64</sup> The Tax Cuts and Jobs Act repealed the authority to issue tax-credit bonds and direct-pay bonds. The repeal applies to new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds issued after December 31, 2017.

In addition to tax credit bonds, the IRS also oversees the issuance of tax-exempt bonds. There are two main types of tax-exempt bonds – private activity bonds and government bonds.<sup>65</sup> Figure 30 shows the size and number of bond issuances by type.

**Figure 30: Size and Number of Tax-Exempt Bonds Issued By Type**



Source: Returns Inventory and Classification System.

## TEB referrals

Prior to the standup of the CP&C function, all referrals (*i.e.*, communications (information/knowledge) sent to the IRS claiming potential noncompliance) received were processed with most approved for examination. After the establishment of the CP&C function, the TE/GE Division processed 36 percent of referrals received during FYs 2018 and 2019 and approved 60 percent of them for examination. The number of closed examinations identified through internal and external referral sources fluctuated considerably ranging from a high of 76 to a low of two closures. Figure 31 shows the number of referrals received, processed, and approved for examination for FYs 2015, 2016, 2018, and 2019.<sup>66</sup>

<sup>65</sup> Private activity bonds are municipal financing arrangements in which more than 10 percent of the proceeds are to be used for any private business. Government bonds are municipal financing arrangements for which bonds are used to finance activities or facilities of a State or local government. This can include financing the construction, maintenance, or repair of public infrastructure such as highways, schools, fire stations, libraries, or other types of municipal facilities.

<sup>66</sup> FY 2017 was a transition year with the standup of the CP&C function, and data were not available in its entirety.

**Figure 31: Number of Referrals Received, Processed,  
and Approved for Examination for the TEB Function**

|                          | FY 2015 | FY 2016 | FY 2018 | FY 2019 |
|--------------------------|---------|---------|---------|---------|
| Receipts                 | 20      | 21      | 10      | 18      |
| Processed                | 20      | 21      | 5       | 5       |
| Approved for Examination | 19      | 18      | 1       | 5       |

*Source: Manually tracked by TEB Referral Coordinator (FYs 2015 and 2016); Reporting Compliance Case Management System (FYs 2018 and 2019).*

In the five-year period, TEB had eight non-examined closures based on referrals. The majority of examined and non-examined cases were from internal referral sources.

### **TEB examinations**

Overall, examination closures increased 26 percent from FY 2015 to FY 2017 and then decreased by 34 percent from FY 2018 to FY 2019. The examination rate of cases closed without any changes to the returns or tax liabilities were steady for FYs 2015 through 2017 but increased substantially in FYs 2018 and 2019. Figure 32 shows the number of closed TEB examinations by outcome.

**Figure 32: Number of TEB Examinations and Non-Examined Closures**

|                                   | FY 2015    | FY 2016    | FY 2017    | FY 2018    | FY 2019    |
|-----------------------------------|------------|------------|------------|------------|------------|
| <b>Total Examination Closures</b> | <b>569</b> | <b>570</b> | <b>717</b> | <b>480</b> | <b>315</b> |
| Total Change Cases                | 257        | 268        | 325        | 144        | 83         |
| Total No Change Cases             | 312        | 302        | 392        | 336        | 232        |
| Percentage No Change              | 55%        | 53%        | 55%        | 70%        | 74%        |
| <b>Total Non-Examined</b>         | <b>187</b> | <b>102</b> | <b>92</b>  | <b>17</b>  | <b>20</b>  |

*Source: Returns Inventory and Classification System.*

IRS officials suggested that the increase in FY 2017 closures is attributed to the TEB function completing more focused examinations and increased managerial oversight of case processing. In addition, the TEB function's examiner staff decreased by 51 percent (35 to 17 examiners) from FY 2015 to FY 2019.

IRS officials surmised that the increased no change rates in FYs 2018 and 2019 might be due to TE/GE Division's reorganization in which afterward the TEB function no longer classified its own cases. Cases classified by the CP&C function in the latter part of FY 2017 would have closed in FY 2018 or later. In addition, from FYs 2015 to 2019 the number of TEB function non-examined cases decreased by 89 percent. According to the IRS, this decrease is due to a heightened focus within the TEB function, prior and subsequent to the CP&C function standup, on ensuring that cases are surveyed (closed without examination) only when necessary.

## **Appendix I**

### **Detailed Objective, Scope, and Methodology**

The overall objective of this review was to provide various statistical information and data trends related to the TE/GE Division. To accomplish our objective, we:

- Researched legislative changes and organizational changes that affected the TE/GE Division.
- Researched applicable TIGTA, Government Accountability Office, and other organizational reports.
- Discussed with TE/GE Division executives any issues, challenges, or risks that are of concern.
- Obtained and analyzed data, records, and other documentation to identify significant trends or changes related to the activities of TE/GE Division EP, EO, and Government Entities functions, including FSL/ET, ITG, and TEB, for FYs 2015 to 2019.
- Compiled TE/GE Division budget and staffing data for TE/GE Division EP, EO, FSL/ET, ITG, CP&C, and TEB functions' activities and assessed trends and issues.
- For any significant trends or aberrations noted in any of the data analysis performed under our subobjectives, discussed with applicable IRS personnel and considered the burden, if any, that the trends may indicate for taxpayers.
- Developed graphical presentations of the various trends identified with TIGTA's Applied Research and Technology Data Analytics team.

### **Performance of This Review**

This review was performed with information obtained from the TE/GE Division during the period March 2020 through February 2021. 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 did not validate the accuracy or reliability of the information generated from the IRS's systems because this review is a statistical portrayal of the IRS's data results. However, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Heather Hill, Assistant Inspector General for Audit (Management Services and Exempt Organizations); Carl Aley, Director; Cheryl Medina, Audit Manager; Sean Morgan, Lead Auditor; Donald Martineau, Auditor; Michael McGovern, Auditor; and Vikram Singh, Auditor.

### **Validity and Reliability of Data From Computer-Based Systems**

We used nationwide data from various IRS management information systems. Due to time and resource constraints, we did not audit the IRS systems to validate the accuracy and reliability of the information.

## **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 did not assess internal controls because doing so was not applicable within the context of our objective. Our analyses were limited to identifying changes and trends in data prepared and reported by the IRS.

## Appendix II

### Additional EP, EO, FSL/ET, and TEB Functions Statistical Data

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**Fiscal Year 2019 Statistical Trends Review of the Tax  
Exempt and Government Entities Division**

**Figure 1: EP Determination Letter Requests  
Received and Processed by Plan Type**

| Plan Type  | FY 2015           | FY 2016           | FY 2017           | FY 2018           | FY 2019          |
|--|-------------------|-------------------|-------------------|-------------------|------------------|
| <b>Receipts</b>  |                   |                   |                   |                   |                  |
| Individually Designed  | 8,973             | 11,353            | 4,680             | 1,651             | 1,401            |
| Pre-Approved   | 679               | 593               | 286               | 235               | 2,021            |
| <b>Total Receipts</b>  | <b>9,652</b>      | <b>11,946</b>     | <b>4,966</b>      | <b>1,886</b>      | <b>3,422</b>     |
| <b>Processed Cases</b>   |                   |                   |                   |                   |                  |
| <b>Individually Designed</b>                                       |                   |                   |                   |                   |                  |
| Defined Benefit  | 4,465             | 3,525             | 3,897             | 2,313             | 742              |
| Defined Contribution   | 5,316             | 4,213             | 6,127             | 3,020             | 640              |
| <b>Pre-Approved</b>  |                   |                   |                   |                   |                  |
| Defined Benefit  | 3                 | 45                | 2                 | 789               | 59               |
| Defined Contribution   | 195               | 61                | 136               | 81                | 37               |
| I.R.C. § 403(b) <sup>1</sup>                                       |                   |                   | 612               | 65                | 36               |
| <b>Total Processed</b>   | <b>9,979</b>      | <b>7,844</b>      | <b>10,774</b>     | <b>6,268</b>      | <b>1,514</b>     |
| Individually Designed Cases Average Cycle Time (Days)              | 448               | 379               | 421               | 371               | 242              |
| Pre-Approved Cases Average Cycle Time (Days)                       | 15                | 14                | 449               | 773               | 63               |
| <b>Number of Employees Included in Individually Designed Plans</b> | <b>31,933,629</b> | <b>29,009,277</b> | <b>31,580,158</b> | <b>10,107,159</b> | <b>1,411,243</b> |
| <b>Average Number of Employees per Plan</b>                        | <b>3,200</b>      | <b>3,698</b>      | <b>2,931</b>      | <b>1,613</b>      | <b>932</b>       |

Source: EP/EO Determination System.

<sup>1</sup> I.R.C. § 403(b) plans relate to tax-sheltered annuity plans for public schools and certain tax-exempt organizations. This type of plan was created in CY 2013 and the IRS began closing related cases in FY 2017, so there is no available data for FYs 2015 and 2016.

**Figure 2: EP Applications Closed by Form Type**

|  | FY 2015      | FY 2016      | FY 2017       | FY 2018      | FY 2019      |
|--|--------------|--------------|---------------|--------------|--------------|
| <b>Individually Designed Plans<sup>2</sup></b> |              |              |               |              |              |
| Form 5300                                      | 7,787        | 5,527        | 6,620         | 4,305        | 497          |
| Form 5307                                      | 699          | 960          | 2,344         | 62           | 19           |
| Form 5310                                      | 1,262        | 1,172        | 1,012         | 900          | 797          |
| Form 5316                                      | 33           | 79           | 48            | 66           | 69           |
| <b>Totals</b>                                  | <b>9,781</b> | <b>7,738</b> | <b>10,024</b> | <b>5,333</b> | <b>1,382</b> |
| <b>Pre-approved Plan Determinations</b>        |              |              |               |              |              |
| <b>Totals</b>                                  | <b>198</b>   | <b>106</b>   | <b>750</b>    | <b>935</b>   | <b>132</b>   |
| <b>Grand Total</b>                             | <b>9,979</b> | <b>7,844</b> | <b>10,774</b> | <b>6,268</b> | <b>1,514</b> |

Source: EP/EO Determination System.

**Figure 3: EP Filings by Plan Type**

| Plan Type            | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|----------------------|---------|---------|---------|---------|---------|
| Defined Benefit      | 86,284  | 83,838  | 85,651  | 86,955  | 85,059  |
| Defined Contribution | 794,932 | 781,035 | 792,626 | 805,529 | 793,464 |
| Other                | 18,652  | 17,183  | 16,595  | 15,609  | 30,020  |
| Unknown              | 22,475  | 18,976  | 14,387  | 15,855  | 15,366  |

Source: EP Master File and Return Transaction File Online Employee Retirement Income Security Act of 1974 Filing Acceptance System Tables.

<sup>2</sup> Form 5300, Application for Determination for Employee Benefit Plan, Form 5307, Application for Determination for Adopters of Modified Volume Submitter Plans, Form 5310, Application for Determination for Terminating Plan, and Form 5316, Application for Group or Pooled Trust Ruling.

**Figure 4: EO Application Requirements for Different Types of Entities**

| Form                     | Title   | Requirements for Use   | Required Filing                             |
|--------------------------|---|--|---|
| Form 1023                | Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code             | Charitable organizations with projected annual gross receipts of more than \$50,000. To qualify for exemption under section 501(c)(3), an organization must be organized and operated exclusively for one or more exempt purposes.   | Yes, (exceptions apply) <sup>3</sup>        |
| Form 1023-EZ             | Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code | Charitable organizations that project annual gross receipts will not exceed \$50,000 in any of the next three years as well as annual gross receipts have not exceeded \$50,000 in any of the past three years. Have total assets in fair market value of which is not in excess of \$250,000. | Yes   |
| Form 1024                | Application for Recognition of Exemption Under Section 501(a)   | This form is used by most types of organizations to apply for recognition under section 501(a) and by all applicants for a determination of plan qualification under section 120.  | Yes, by most types of organizations         |
| Form 1024-A <sup>4</sup> | Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code             | Form 1024-A provides notice to the IRS that an organization intends to operate as a section 501(c)(4) organization.  | No  |
| Form 1025                | Exemption Application   | Form obsolete.   | No  |
| Form 1026                | Exemption Application   | Form obsolete. Organizations submit a written request for a group exemption.   | No  |
| Form 1028                | Application for Recognition of Exemption Under Section 521 of the Internal Revenue Code                   | Form 1028 may be used by a farmers' cooperative to apply for recognition of exempt status under section 521.   | No  |
| Form 8940                | Request for Miscellaneous Determination   | Organizations exempt under section 501(c)(3) should file Form 8940 for miscellaneous determinations under I.R.C. §§ 507, 509(a), 4940, 4942, 4945, and 6033. Nonexempt charitable trusts should also file a Form 8940 for an initial determination under section 509(a)(3).                    | Yes, if taking certain actions <sup>5</sup> |

Source: IRS publications and procedures.

<sup>3</sup> For example, churches, synagogues, temples, and mosques are not required to file an application for tax-exempt status.

<sup>4</sup> This form was implemented beginning in January 2018 per the Protecting Americans From Tax Hikes Act of 2015 specifically for social welfare organizations.

<sup>5</sup> Actions include, requesting exemption for Form 990 filing requirements, advance approval of voter registration activities, advance approval of scholarship procedures, as well as others.

**Figure 5: EO Determination Letter  
Requests Received by Application Type**

| Application Type      | FY 2015       | FY 2016       | FY 2017       | FY 2018       | FY 2019       |
|-----------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Receipts</b>       |               |               |               |               |               |
| Form 1023             | 36,844        | 33,396        | 30,507        | 28,259        | 27,374        |
| Form 1023-EZ          | 44,872        | 48,517        | 56,361        | 59,505        | 62,513        |
| Form 1024             | 7,723         | 7,523         | 6,569         | 5,082         | 4,566         |
| Form 1024-A           |               |               |               | 864           | 1,485         |
| Form 1025             | 13            | 17            | 19            | 13            | 44            |
| Form 1026             | 95            | 113           | 99            | 110           | 97            |
| Form 1028             | 2             | 6             | 11            | 4             | 7             |
| Form 8940             | 1,270         | 1,586         | 1,611         | 1,691         | 1,850         |
| <b>Total Receipts</b> | <b>90,819</b> | <b>91,158</b> | <b>95,177</b> | <b>95,528</b> | <b>97,936</b> |

*Source: EP/EO Determination System.*

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**Figure 6: EO Receipts by I.R.C. Subsection**

| I.R.C. Subsection            | Type of Exempt Organization  | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|------------------------------|--|---------|---------|---------|---------|---------|
| § 501(c)(2)                  | Title Holding Corporation For Exempt Organization  | 181     | 193     | 144     | 148     | 127     |
| § 501(c)(3)                  | Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations | 83,060  | 83,576  | 88,554  | 89,547  | 91,809  |
| § 501(c)(4)                  | Civic Leagues, Social Welfare Organizations; and Local Associations of Employees   | 1,901   | 1,872   | 1,561   | 1,552   | 1,566   |
| § 501(c)(5)                  | Labor, Agricultural, and Horticultural Organizations   | 705     | 648     | 535     | 468     | 486     |
| § 501(c)(6)                  | Business Leagues, Chambers of Commerce, Real Estate Boards, etc.   | 1,842   | 1,649   | 1,471   | 1,299   | 1,385   |
| § 501(c)(7)                  | Social and Recreational Clubs  | 1,371   | 1,280   | 1,344   | 1,179   | 1,179   |
| § 501(c)(8)                  | Fraternal Beneficiary Societies and Associations   | 399     | 317     | 339     | 231     | 295     |
| § 501(c)(9)                  | Voluntary Employees' Beneficiary Associations  | 121     | 166     | 107     | 84      | 142     |
| § 501(c)(10)                 | Domestic Fraternal Societies and Associations  | 201     | 459     | 185     | 186     | 140     |
| § 501(c)(12)                 | Benevolent Life Insurance Associations, Mutual Ditch or Irrigation Companies, Mutual or Cooperative Telephone Companies, and Like Organizations  | 104     | 82      | 91      | 100     | 100     |
| § 501(c)(13)                 | Cemetery Companies   | 302     | 274     | 267     | 254     | 224     |
| § 501(c)(14)                 | State-Chartered Credit Unions, Mutual Reserve Funds  | 9       | 12      | 13      | 8       | 42      |
| § 501(c)(19)                 | Post or Organization of Past or Present Members of the Armed Forces  | 575     | 561     | 514     | 428     | 410     |
| § 501(c)(25)                 | Title Holding Corporations or Trusts with Multiple Parent Corporations   | 36      | 54      | 31      | 30      | 21      |
| Other <sup>[1]</sup> (total) |  | 12      | 15      | 21      | 14      | 10      |

Source: EP/EO Determination System. [1] 'Other' includes the total receipts for nine other I.R.C. subsections with 30 or less filings for FYs 2015 through 2019.

**Figure 7: EO Annual Information Returns Filed<sup>6</sup>**

|                        | FY 2015          | FY 2016          | FY 2017          | FY 2018          | FY 2019          |
|------------------------|------------------|------------------|------------------|------------------|------------------|
| <b>Total Filings</b>   | <b>1,576,802</b> | <b>1,497,870</b> | <b>1,525,627</b> | <b>1,600,855</b> | <b>1,587,359</b> |
| Form 990               | 323,106          | 314,014          | 310,344          | 317,199          | 321,095          |
| Form 990-EZ            | 269,607          | 244,505          | 243,451          | 239,085          | 241,899          |
| Form 990-N             | 577,311          | 557,908          | 604,318          | 641,832          | 651,691          |
| Form 990-PF            | 111,218          | 110,146          | 109,513          | 113,215          | 115,316          |
| Form 990-T             | 185,161          | 165,969          | 154,784          | 188,334          | 161,001          |
| Form 4720              | 2,380            | 2,211            | 2,347            | 2,475            | 2,294            |
| Form 5227 <sup>7</sup> | 108,019          | 103,117          | 100,870          | 98,715           | 94,063           |

*Source: Publication 6292, Fiscal Year Return Projections for the United States.*

**Figure 8: EO Form 990-T Filings and Amounts Paid**

| <b>Tax Year</b> | <b>Total Number of Filings</b> | <b>Number of Filings With Tax Assessments Less Than or Equal to Zero Dollars</b> | <b>Number of Filings With Tax Assessments Greater Than Zero Dollars</b> | <b>Total Amount of Tax Assessments</b> |
|-----------------|--------------------------------|--|---|--|
| TY 2015         | 166,815                        | 124,966  | 41,849  | \$706,880,093.58                       |
| TY 2016         | 160,886                        | 124,128  | 36,758  | \$736,343,061.56                       |
| TY 2017         | 203,762                        | 140,514  | 63,248  | \$929,966,934.35                       |
| TY 2018         | 204,558                        | 128,294  | 76,264  | \$704,636,412.13                       |
| TY 2019         | 2,091                          | 1,283  | 808   | \$7,459,012.13                         |

*Source: Returns Inventory and Classification System.*

<sup>6</sup> Publication 6292, *Fiscal Year Return Projections for the United States*, reports actual and forecasted return counts. Figure 7 is reporting the actual return counts.

<sup>7</sup> *Split-Interest Trust Information Return.*

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**Figure 9: FSL/ET Entity Definitions**

| Entity                   | Types of Entities  |
|--------------------------|--|
| Local Governments        | Local governments without another specific project code. Common examples: hospitals, health/emergency service districts, transit authorities, utility districts (water, waste-water, electricity, etc.), parks/recreation districts, development districts, local courts, etc. |
| State Governments        | State Governments, as well as departments of State Governments (lottery commissions, unemployment commissions, etc.), State colleges and universities.   |
| Federal Government       | Federal Government agencies, as well as military and military related organizations such as officer's clubs.   |
| County Governments       | Counties, parishes, etc.   |
| Municipality Governments | Cities, towns, villages, boroughs, etc.  |
| Schools                  | Local government school districts, boards of education, etc.   |
| Community Colleges       | Local government operated colleges, technical colleges, college districts, etc.  |
| Fire Districts           | Local government fire districts.   |
| Housing Authorities      | Local government housing authorities.  |

*Source: IRS analysis of project codes within the Returns Inventory and Classification System.*

**Figure 10: FSL/ET Closed Examination Returns and Change Results by Entity Type**

| Entity Type           | FY 2015                |                | FY 2016                |                | FY 2017                |                | FY 2018                |                | FY 2019                |                |
|-----------------------|------------------------|----------------|------------------------|----------------|------------------------|----------------|------------------------|----------------|------------------------|----------------|
|                       | Overall Closed Returns | Change Returns | Overall Closed Returns | Change Returns | Overall Closed Returns | Change Returns | Overall Closed Returns | Change Returns | Overall Closed Returns | Change Returns |
| Local                 | 164                    | 140            | 162                    | 150            | 180                    | 148            | 223                    | 155            | 164                    | 136            |
| State                 | 146                    | 137            | 169                    | 143            | 133                    | 128            | 183                    | 153            | 249                    | 227            |
| Federal               | 45                     | 33             | 70                     | 33             | 51                     | 31             | 37                     | 28             | 6                      | 1              |
| County                | 410                    | 374            | 346                    | 318            | 294                    | 274            | 254                    | 211            | 202                    | 189            |
| Municipality          | 623                    | 587            | 483                    | 451            | 459                    | 431            | 489                    | 411            | 261                    | 231            |
| School                | 498                    | 470            | 534                    | 480            | 358                    | 323            | 319                    | 263            | 285                    | 246            |
| Community College     | 69                     | 57             | 91                     | 83             | 66                     | 66             | 52                     | 40             | 29                     | 21             |
| Fire District         | 22                     | 22             | 0                      | 0              | 0                      | 0              | 0                      | 0              | 0                      | 0              |
| Housing Authority     | 21                     | 21             | 17                     | 16             | 71                     | 59             | 125                    | 100            | 42                     | 33             |
| EO Cases <sup>8</sup> |                        |                |                        |                |                        |                | 5                      | 1              | 111                    | 78             |
| <b>Totals</b>         | <b>1,998</b>           | <b>1,841</b>   | <b>1,872</b>           | <b>1,674</b>   | <b>1,612</b>           | <b>1,460</b>   | <b>1,687</b>           | <b>1,362</b>   | <b>1,349</b>           | <b>1,162</b>   |

*Source: Returns Inventory and Classification System.*

<sup>8</sup> EO Cases are cases the FSL/ET area completed on EO entities after the reorganization in May 2017.

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**Figure 11: FSL/ET Closed Examinations by Principal Issue**

| (Principal Issue Code) Principal Issue                              | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|---|---------|---------|---------|---------|---------|
| (01) Filing Requirements  | 145     | 179     | 140     | 236     | 100     |
| (11) Unreported Compensation  | 643     | 789     | 598     | 517     | 391     |
| (12) Taxable Fringe Benefits  | 485     | 638     | 541     | 459     | 470     |
| (13) Accountable Plans  | 398     | 330     | 411     | 314     | 360     |
| (15) Employee Classification  | 733     | 735     | 657     | 691     | 603     |
| (17) Federal Insurance Contributions Act Tax/Coverage               | 572     | 655     | 319     | 363     | 206     |
| (18) Federal Withholding Tax  | 70      | 41      | 23      | 4       | 9       |
| (19) Federal Withholding Tax - Backup                               | 188     | 236     | 199     | 269     | 235     |
| (20) Non-Resident Agent   | 24      | 56      | 49      | 52      | 34      |
| (23) Employee Benefit Plans   | 4       | 0       | 1       | 0       | 0       |
| (24) Discrepancy Adjustment   | 1       | 0       | 4       | 4       | 0       |
| (29) Discrepancy Adjustment - Fail to File Penalty                  | 7       | 0       | 0       | 1       | 0       |
| (32) Penalties  | 13      | 0       | 0       | 0       | 0       |
| (43) Penalties - Failure to File Correspondence Information Returns | 14      | 5       | 35      | 4       | 37      |

*Source: Returns Inventory and Classification System.*

**Figure 12: TEB - Top Five Market Segments  
Based on Number of Returns Filed**

| Market Segment | Number of Returns | Total Amount Issued |
|----------------|-------------------|---------------------|
| Other          | 58,589            | \$730,933,961,852   |
| Education      | 37,394            | \$664,840,499,965   |
| Lease          | 25,139            | \$1,153,277,780     |
| Utilities      | 14,146            | \$289,321,185,588   |
| Public Safety  | 11,874            | \$36,351,981,341    |

*Source: Returns Inventory and Classification System.*



## Appendix III

### Abbreviations

|        |   |
|--------|---|
| CP&C   | Compliance Planning and Classification                |
| CY     | Calendar Year   |
| EO     | Exempt Organizations                                  |
| EP     | Employee Plans  |
| FSL/ET | Federal, State and Local (Governments)/Employment Tax |
| FY     | Fiscal Year   |
| I.R.C. | Internal Revenue Code                                 |
| IRS    | Internal Revenue Service                              |
| ITG    | Indian Tribal Governments                             |
| O&E    | Outreach and Education                                |
| TEB    | Tax-Exempt Bonds                                      |
| TECU   | Tax Exempt and Government Entities Compliance Unit    |
| TE/GE  | Tax Exempt and Government Entities                    |
| TIGTA  | Treasury Inspector General for Tax Administration     |
| TY     | Tax Year  |



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