

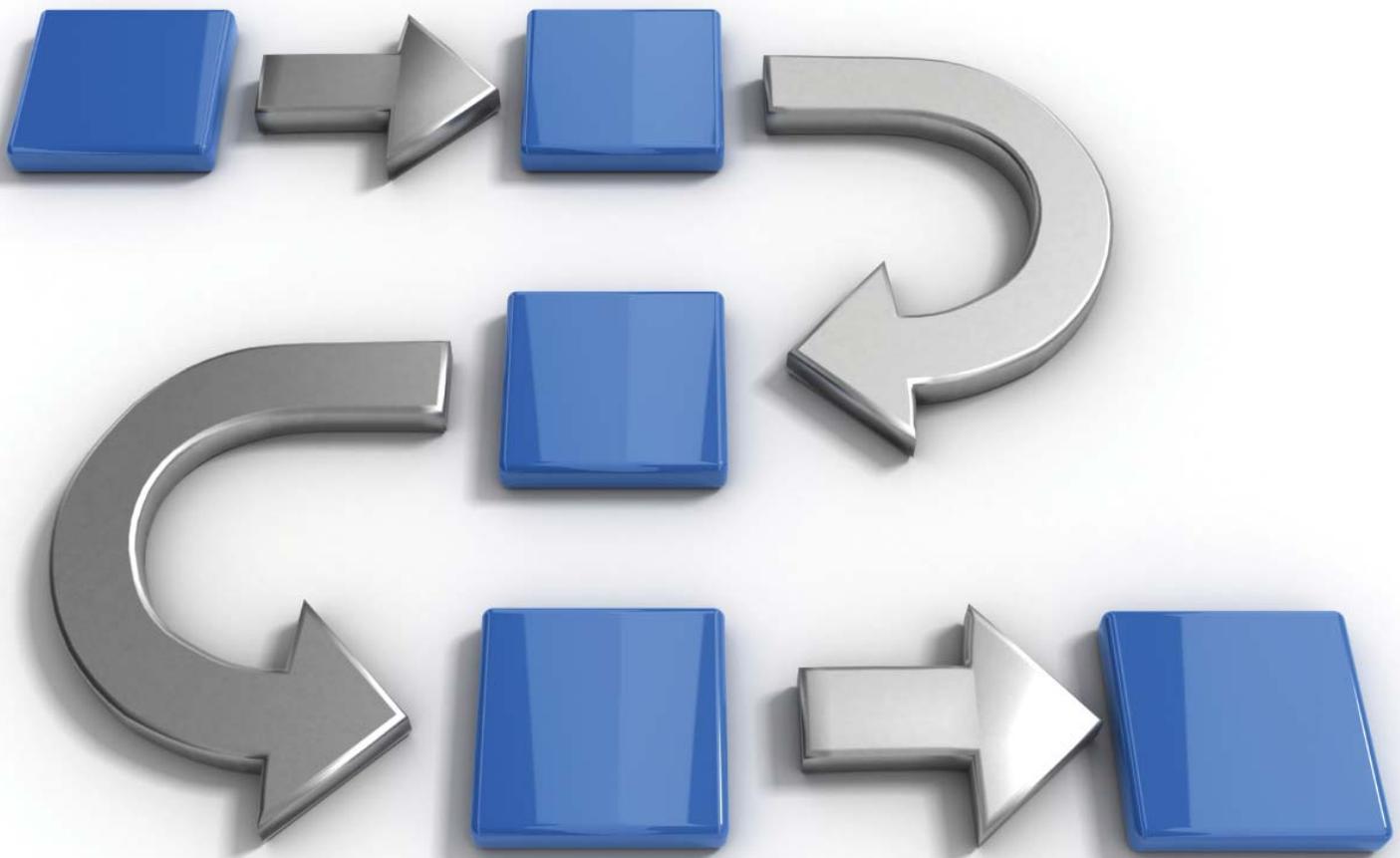
GAME

By Steven W. Hoffman, MsT, EA, CFP®

Are you feeling like the IRS might be watching you a little bit more closely these days. Sometimes your intuition is right. A new report from the IRS's division of Tax Exempt and Government Entities confirms your suspicions. Lois Lerner, Director, Exempt Organizations Division, recently released the accomplishments of the prior fiscal year and gives us some insights into what to expect in the fiscal year of 2011. The 29-page report shows the priorities she has outlined that may affect you. The entire report is good reading, but I've highlighted some of the major points of importance to you.

PLAN

Nonprofits vs. the IRS



What Happened in Fiscal Year 2010?

The IRS increased the monitoring of nonprofit organizations. The numbers show that the Service has stepped up its efforts to check on charity compliance. For example:

- Audits of exempt organizations increased from 7,861 in FY 2008 to 10,187 in FY 2009 (a 30 percent rise) and to 11,449 in FY 2010 (another 12 percent). This is a significant three-year trend in audits of nonprofit organizations that appears will continue into the future. If you've been playing what I call 'audit roulette' and think you won't be audited, your chances at the table just went up. This is a game you don't want to play and really don't want to win.
- IRS compliance checks (in which they ask about a specific item on a Form 990 or for more information on an organization's operations by mail) are also being used extensively. They require fewer resources and as the report states, the checks will enable the IRS to "touch more organizations than by using an exclusively exam-based strategy." It's important to take these letters seriously and ensure you respond to them in a timely manner. I suggest you involve your accountants or your Audit Committee and even an outside consultant to help you draft your response. Often times your response can lead to more inquiries from the IRS and has the potential to lead to an audit of your organization. Many organizations show me this letter from the IRS, sometimes unopened, six months after they have received it.

- The IRS is working more closely with the Social Security Administration and all the states to identify nonfilers and noncompliant organizations more effectively so that the cases selected for exams are more likely to result in finding significant issues. This means they are focusing their efforts on those examinations that will most likely uncover issues and possibly result in assessments of tax, interest and penalties.
- The IRS is putting its money where its mouth is. There has been a growth in the Exempt Organizations staffing. There are more people in EO filling more jobs. The total number of employees has grown from 837 positions in 2008 to 910 in 2009, with another increase to 942 in 2010. Specifically and more informative is that 100 of these new positions over the two-year period were in the Examinations area. In comparison, staffing in all other major areas (Rulings & Agreements, Customer Education & Outreach, and Director's Office) only increased by a total of five from FY 2008 to FY 2010. They are beefing up the resources needed

to make more examinations of nonprofit organizations.

What Else is Happening?

The revised Form 990 was first used for filing in 2008, so the first full year of filings using the revised form is close to complete, and the second well underway. Have you noticed there is more media coverage of nonprofit organizations because of the amount of disclosure on the new Form 990. Not all of it is positive, with many revelations making the newspapers.

There are some indications of improvements in compliance in the second year of the new form's use. With the use of the new form, all Form 990 filers are required to complete some information on Schedule O. In 2008, about 79 percent of the filers included it. That figure increased to 90 percent for those filing in 2009.

More organizations are e-filing (about 13 percent e-filed Forms 990 and 990-EZs in 2007; that figure grew to 19 percent in 2008). Only the largest organizations are typically required to e-file, but many others are discovering the ease and cost savings of doing so. Additionally, the threshold for filing Form 990 and the Form 990-N is changing. Do you know which form to file?

2011 Filing Requirements

Form	Gross Receipts
990-N	Less than or equal to \$50,000
990-EZ or 990	Greater than \$50,000 and less than \$200,000, and total assets less than \$500,000
990	Equal to or greater than \$500,000, and total assets equal to or greater than \$500,000

What's Planned for FY 2011?

Nationally, the IRS has announced that over the next three years it will perform exams on employment tax issues. The Exempt Organization Division gets to play in this sandbox too. The EO Division's share of this national program is 500 focused audits of exempt organizations per year for the next three years. My advice is to brush up on the fringe benefit rules and get into compliance.

Part of the reasoning for the revised Form 990 (besides Congressional attention to nonprofit organizations) was to collect the data that the IRS needed to ensure compliance. My experience has been that the IRS collects a lot of data, employs a lot of people to review and analyze that data and then develops programs that are targeted to improve compliance. This means, as the Director stated, the effort moves from project to process, meaning you'll see more focus on issues the IRS believes are critical to its role as the administrator of tax laws. Now the IRS will be using the information to focus its limited resources.

The IRS will now begin cross checking compensation reporting with the Social Security Administration. The time frame for reporting compensation is the same as W-2 reporting now, thus the information can be compared to what was reported to the SSA. The IRS will be looking for differences between what is reported on Form 990 and what has been reported on the Form W-2 or 941, or if there are other reporting discrepancies.

Supporting organizations, typically set up to benefit one charity, are also targeted for special review of their charitable purpose. Other nonprofits will also be reviewed to determine if they really have been es-

“Audits of exempt organizations increased 42% over the last three years.”

tablished for a charitable purpose or if they are primarily self-serving.

The IRS has an interest in the reporting of loans to officers, directors, trustees and key employees over the past several years. This has resulted in tax assessments of over \$5.5 million and over \$480,000 in employment taxes. The IRS also found many errors in reporting that needed adjustments, and it plans to continue its review of these loans. We just went through an election year and the IRS investigated allegations of prohibited political activity by exempt entities. They are developing better processes to handle these issues.

What Nonprofits Should Do

The IRS will be continuing its efforts to ensure that the nonprofit sector complies with the requirements that come with being a tax-exempt organization. Nonprofits can take some simple steps to lessen the likelihood of receiving an inquiry from the IRS in the coming year.

- Increase awareness of tax compliance throughout your organization. Send employees with tax responsibilities to some training. Can't afford that? Bring training in house. Think you can't afford that? Collaborate with another nonprofit to share the cost and arrange joint training.
- Make sure that what's reported in compensation on Form 990 matches what is reported to other federal agencies, such as the Social Security Administration.
- Confirm that income taxes and other payments related to employees, such as Social Security and unemployment compensation (if required), are correctly reported and transmitted to the appropriate agencies.
- If loans have been made to executives, trustees, and other key employees, be aware that the IRS will be reviewing them, so be sure to report accurately. It's an issue they have been investigating.
- Check out what political activity is allowed and what is prohibited—an updated IRS publication is now available on www.irs.gov.
- File Form 990 completely, accurately and on time. The threshold levels for organizations allowed to file the Form 990-EZ have changed significantly in the past several years, allowing the phase-in of the revised Form 990. Many organizations that have been filing Form 990-EZ for two years may now have to change to the full Form 990. Verify which form is required. ▽

Steve Hoffman, MsT, EA, CFP® is an experienced tax resource for nonprofit organizations. He is available to present seminars and workshops in your area. He has 15 years of employment experience with the IRS and has held director of taxation positions at major nonprofit organizations. He specializes in nonprofit taxation, finance, and board development and provides advice to start up nonprofit organizations. For more information, send an email to StevenWHoffman@gmail.com, follow him on Twitter at stevenwhoffman, or read his blog at <http://yourmostvaluableasset.blogspot.com>.