

**Review of the Tax Exempt and Government
Entities Division's Independent Review
Process**

February 2004

Reference Number: 2004-10-045



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

February 25, 2004

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT
ENTITIES DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Review of the Tax Exempt and Government
Entities Division's Independent Review Process
(Audit # 200310029)

This report presents the results of our review of the Tax Exempt and Government
Entities (TE/GE) Division's Independent Review Process (IRP)

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[Redacted]

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In summary, TE/GE Division management followed established procedures when
referring [redacted] cases to the IRP.

[Redacted]

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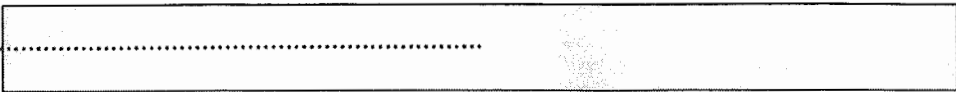

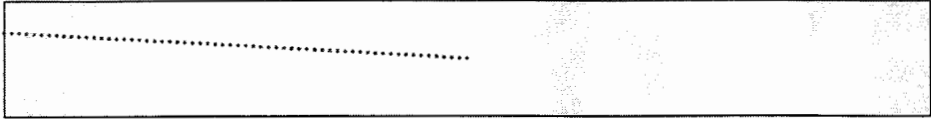

We recommended the Commissioner, TE/GE Division, prepare and submit for issuance public guidance to reemphasize the IRS' position on political activity and private benefit related to exempt organizations.

Management's Response: TE/GE Division management agreed with our recommendation and will develop and submit to TE/GE Division Counsel and the Department of the Treasury the recommended public guidance. Management's complete response to the draft report is included as Appendix VI.

Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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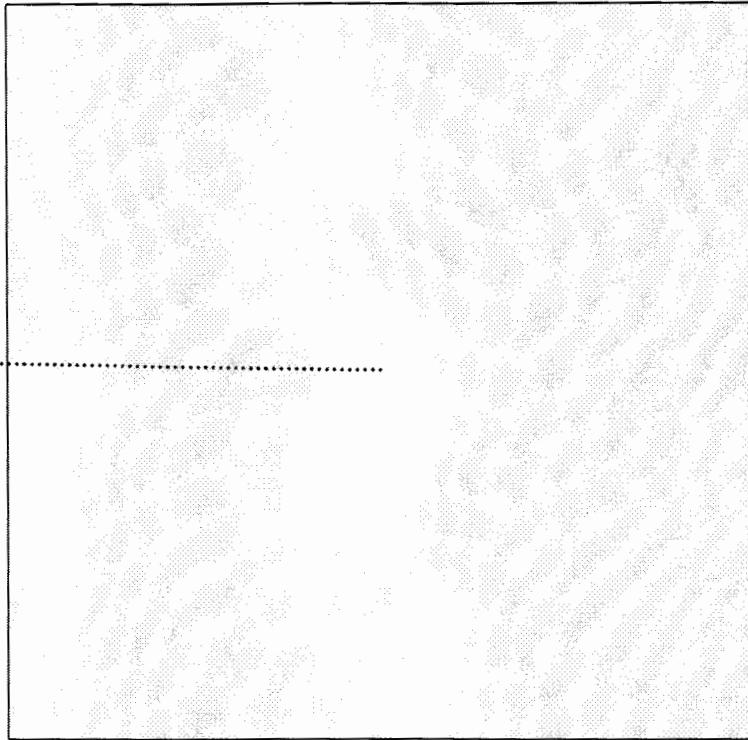
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**Review of the Tax Exempt and Government Entities Division's
Independent Review Process**

Background

The Tax Exempt and Government Entities (TE/GE) Division's Independent Review Process (IRP) was created to provide TE/GE Division management with an internal mechanism to ensure consistency, fairness, and accuracy related to case processing. The IRP was originally envisioned to provide a structured and fair review of sensitive cases handled by the TE/GE Division (e.g., Exempt Organizations, Employee Plans, Indian Tribal Governments, Tax Exempt Bonds, etc.). Within the TE/GE Division, the Office of the Senior Technical Advisor (STA) was responsible for providing an independent technical review of the cases referred to the IRP.



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This audit was conducted in accordance with *Government Auditing Standards* during the period June through November 2003. The audit was performed by interviewing TE/GE Division management at their Division Headquarters in Washington, D.C., and the Baltimore, Maryland office, and by reviewing documentation related to the creation and subsequent termination of the IRP and the cases referred to the IRP at the time of our review. [REDACTED]

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Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

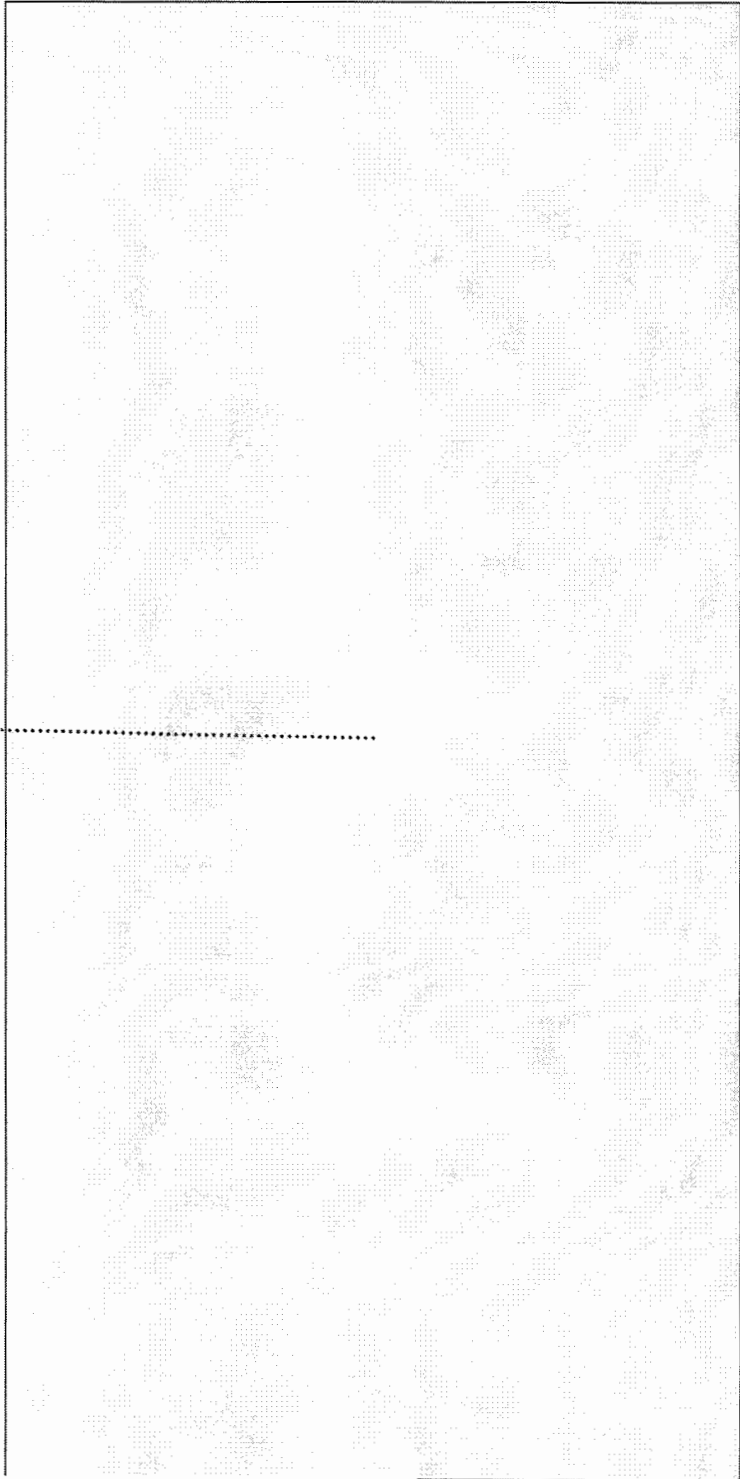
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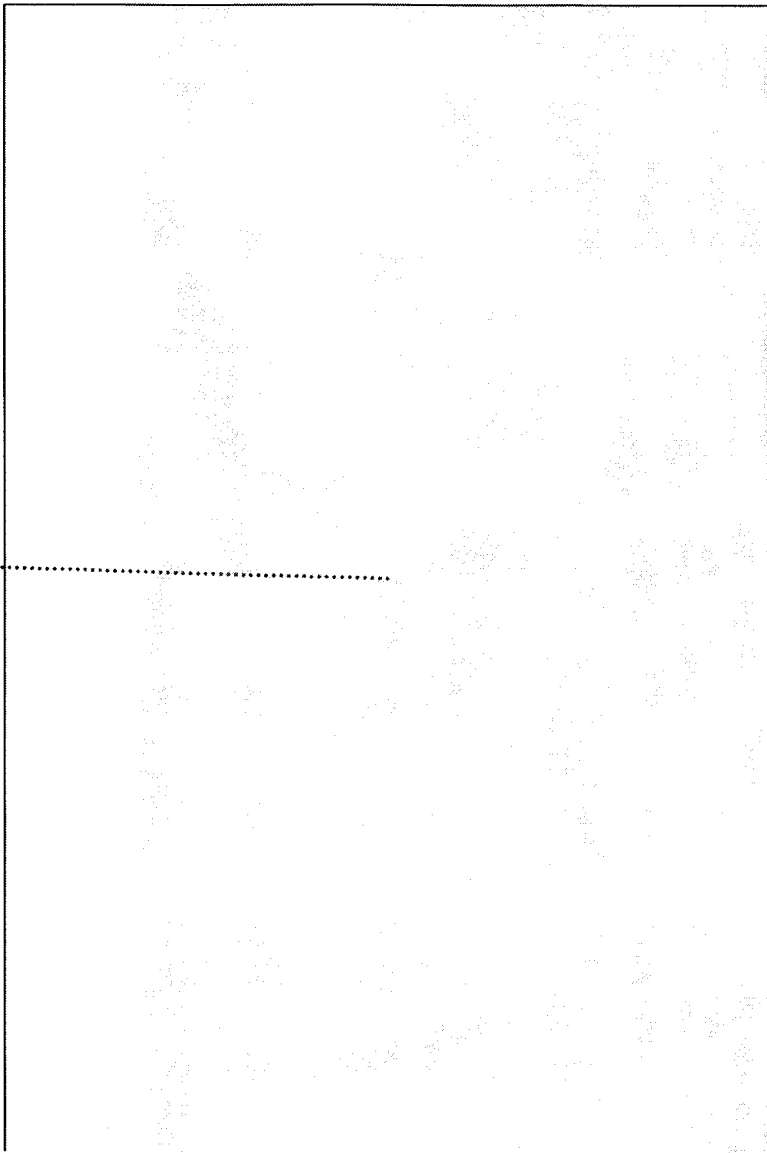
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According to TE/GE Division Counsel management, the current process is that EO issues (including revocation letters) are assigned to field attorneys with experience in those issues and that sensitive or complex issues are to be discussed and coordinated with TE/GE Division Counsel experts in the Headquarters Office. Any disagreements should be elevated to the Assistant Chief Counsel or Division Counsel level, as necessary. Although this process is not a formal procedure, the TE/GE Division Counsel stated this process is reinforced through monthly teleconferences among Division Counsel EO-specialist attorneys and managers in the field and in the Headquarters Office (referred to collectively as "the EO practice

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group”), during which employees compare information and discuss technical issues. These teleconferences provide more consistency in working cases and establish the working relationships that will enable better coordination on individual cases. Based on the Division Counsel reorganization and the current practice of assigning work to specialists who coordinate sensitive issues with the Headquarters Office, we are not making a recommendation to address this issue.

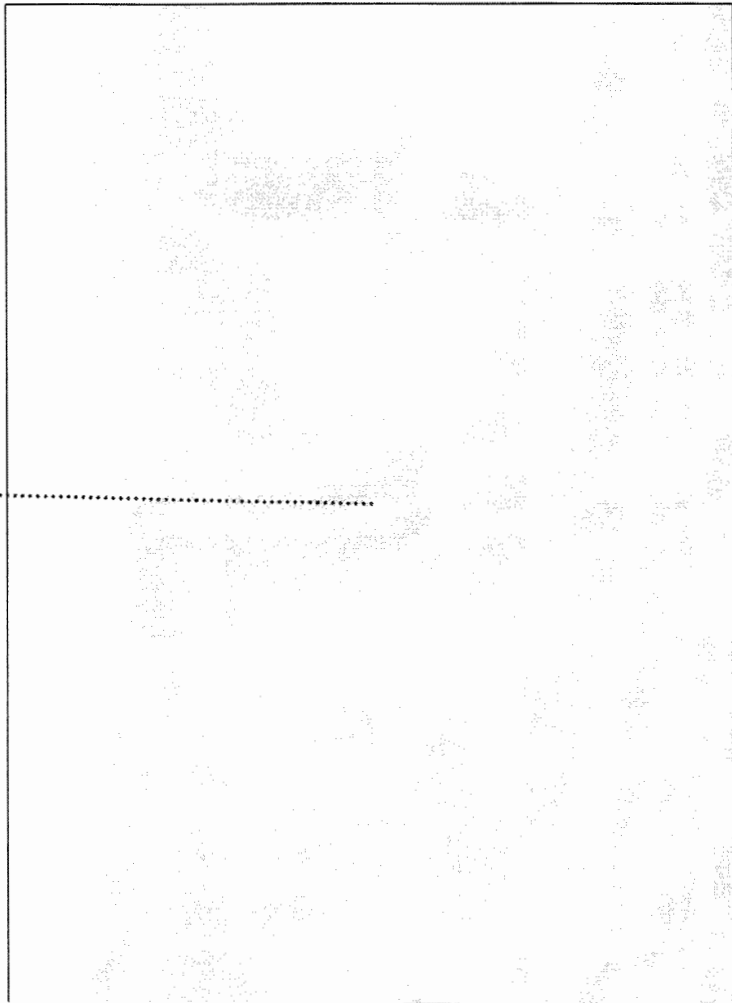
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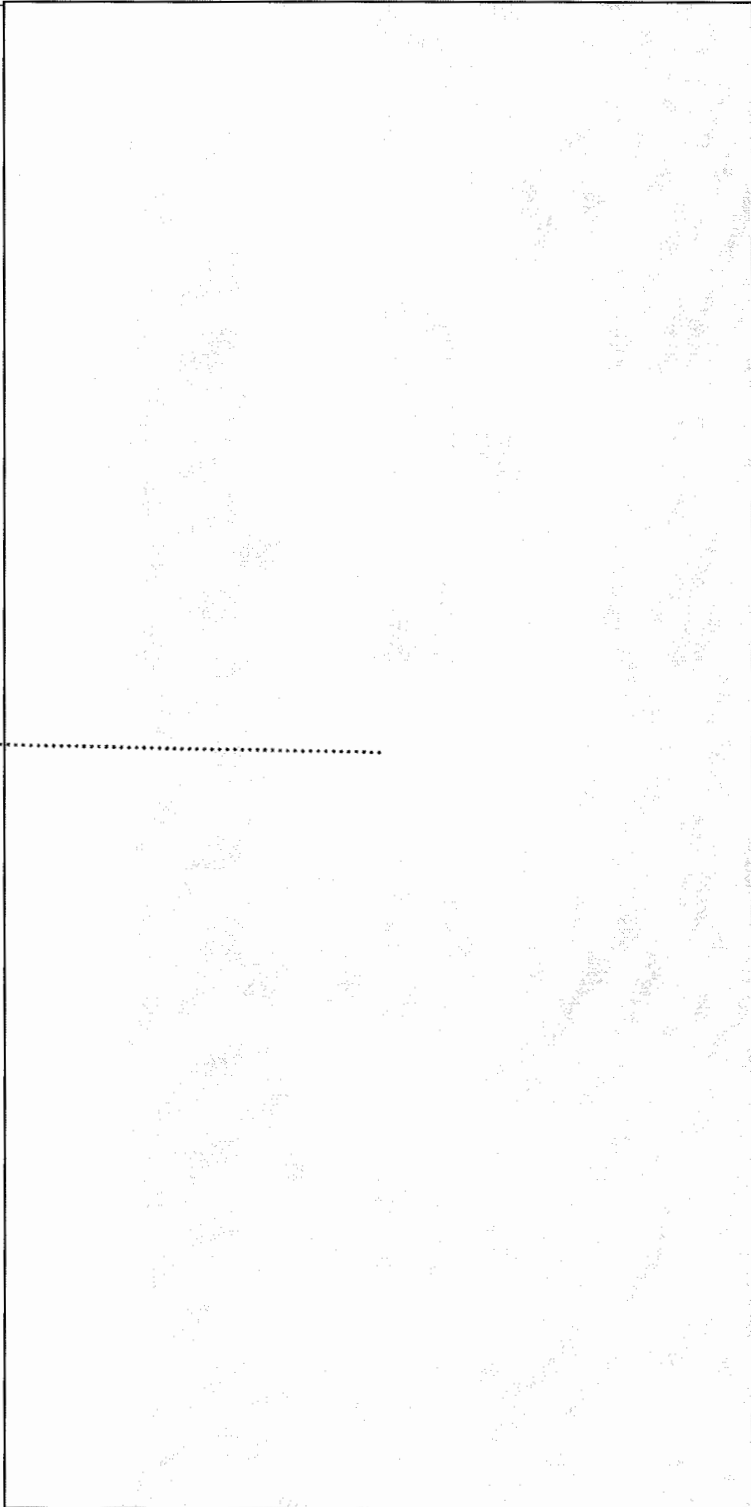
For any case referred to the IRP, IRS guidelines state the STA will have access to all files, documents, and other materials relating to the case. Generally, the STA may consult with any TE/GE Division employees regarding the development of the case or matter and, if the circumstances warrant, receive submissions and/or hold conferences with third parties, including entities, organizations, or individuals that may be affected by the ultimate disposition of the case. Further, the STA may consult with the TE/GE Division/Associate Chief Counsel regarding Counsel's position in the case or matter or initiate Counsel's consideration of the case or matter if Counsel has not been previously consulted.

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**The Independent Review
Process Was Envisioned As
Early As 1999, and [REDACTED] Cases
Were Referred for Review Prior
to Its Elimination**

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[REDACTED]

TE/GE Division management followed established procedures when referring cases to the IRP.

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[REDACTED]

As early as February 1999, the creation of the IRP was proposed as part of the original plan to create the TE/GE Operating Division. The stand-up⁷ of the TE/GE Operating Division was completed in December 1999, but the IRP did not become operational until March 2001 when the position of the STA was filled. According to the Commissioner, TE/GE Division, the position of the STA was not filled until then due to higher priorities related to the stand-up of the TE/GE Operating Division.

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[REDACTED]

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[REDACTED] seemed to indicate the general public did not know the IRP existed or what its role was.

⁷ Stand-up is defined as the first day upon which a group or organization begins to operate under a new design.

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As stated earlier, the TE/GE Division did not envision the IRP to be available to the public; it was for TE/GE Division management's use in sensitive cases handled by the TE/GE Division. With the exception of the press release issued March 14, 2001, announcing the selection of the STA, the TE/GE Division has not performed any outreach efforts to inform its customers of the IRP. [REDACTED]

These factors may have contributed to the public's lack of awareness of this process.

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Senior TE/GE Division management properly approved cases referred for independent review

TE/GE Division procedures state that cases are to be referred to the IRP usually after being elevated to the applicable TE/GE Division Director and approved by the TE/GE Commissioner or Deputy Commissioner. In unusual circumstances, the Commissioner, TE/GE Division, may refer a case to the IRP without a request from a Director.

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We determined TE/GE Division management followed established procedures when referring cases to the IRP. Since its creation, [REDACTED] cases have been referred to the IRP.

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[REDACTED]

Based upon contacts with each of the four TE/GE Division Directors (EP, EO, Government Entities, and Customer Account Services), no other cases have been recommended to the Commissioner, TE/GE Division, for referral to the IRP.

TE/GE Division management decided to eliminate the IRP

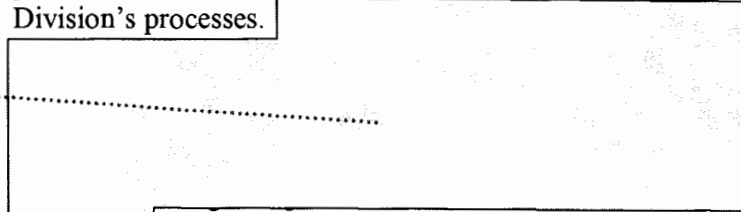
During the fieldwork phase of our review, the Commissioner, TE/GE Division, informed senior TIGTA

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management of the IRS' decision to eliminate the IRP within the TE/GE Division. This decision was effective August 25, 2003.

TE/GE Division management informed us that the IRP was never intended to be an appellate process for TE/GE Division customers. Instead, it was intended to provide TE/GE Division management with an internal mechanism to ensure consistency, fairness, and accuracy related to case processing. In addition, TE/GE Division management stated the IRP was intended to enhance the public's perception of the fairness and impartiality of the TE/GE Division's processes.

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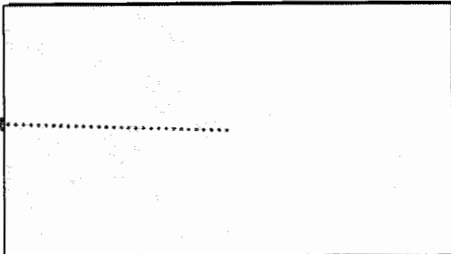


the Commissioner, TE/GE Division, and the Office of the IRS Commissioner decided to terminate the IRP.

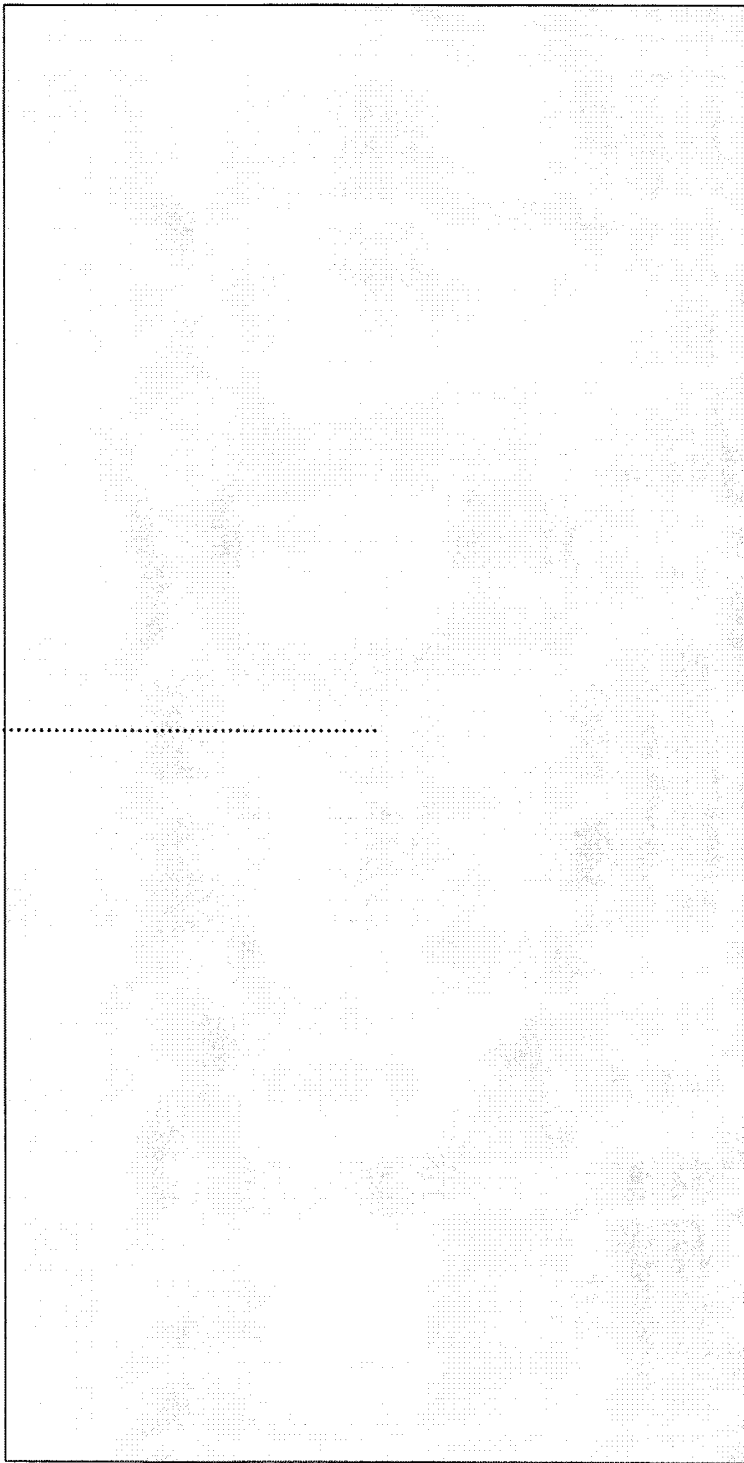
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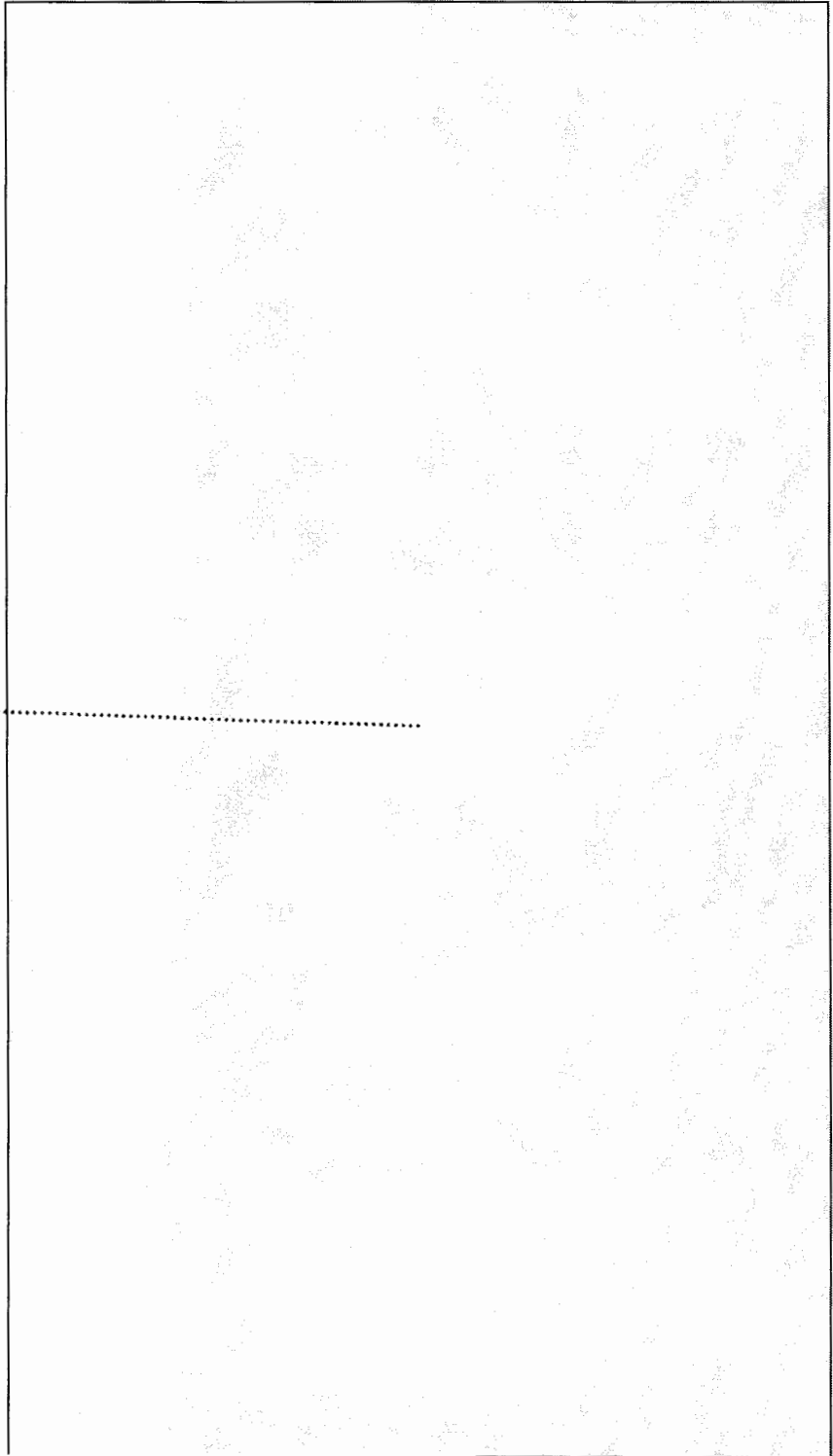
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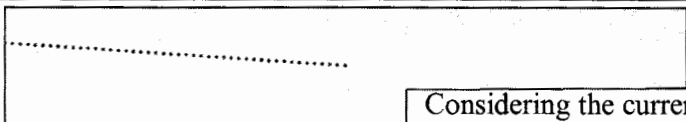
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Considering the current environment and potentially incorrect assumptions about exempt organizations and political activity, there is a need for clarification from the IRS on this matter.

Recommendation

1. The Commissioner, TE/GE Division, should prepare and submit for issuance public guidance to reemphasize the IRS' position on political activity and private benefit related to I.R.C. § 501(c)(3) organizations.

Management's Response: TE/GE Division management agreed to develop and submit to TE/GE Division Counsel and the Department of the Treasury the recommended public guidance. TE/GE Division management noted that the issue is difficult and development of appropriate and effective guidance in this area is elusive. Any guidance submitted will require the independent concurrence of TE/GE Division Counsel and the Department of the Treasury.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the Tax Exempt and Government Entities (TE/GE) Division's Independent Review Process (IRP)

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[Redacted]

We performed the following tests:

- I. Evaluated the use of the IRP within the TE/GE Division.
 - A. Interviewed TE/GE Division personnel and obtained documentation to determine when and why the IRP was established and subsequently terminated.
 - B. Obtained documentation detailing the procedures for the IRP and any actions taken to inform customers of the process.
 - C. Interviewed the four TE/GE Division Directors (Employee Plans, Exempt Organizations, Customer Account Services, and Government Entities) to determine whether they had requested any cases for referral to the IRP that were denied.

- II. Determined whether the TE/GE Division followed established procedures when referring [Redacted] cases to the IRP.

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III.

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Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Nancy Nakamura, Director

Jeffrey M. Jones, Audit Manager

Margaret Anketell, Senior Auditor

Cheryl Medina, Senior Auditor

Andrew Burns, Auditor

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Appendix III

Report Distribution List

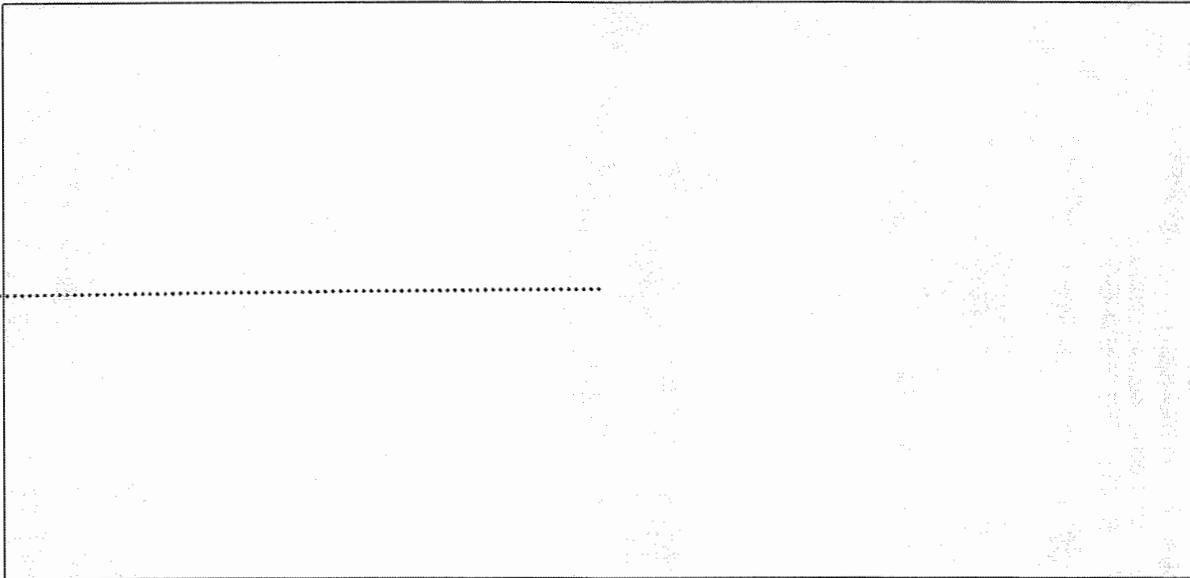
Commissioner C
Office of the Commissioner - Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Director, Communications and Liaison, Tax Exempt and Government Entities Division SE:T:CL
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
Deputy Chief Financial Officer, Department of the Treasury

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Appendix IV

Timeline of Key Events

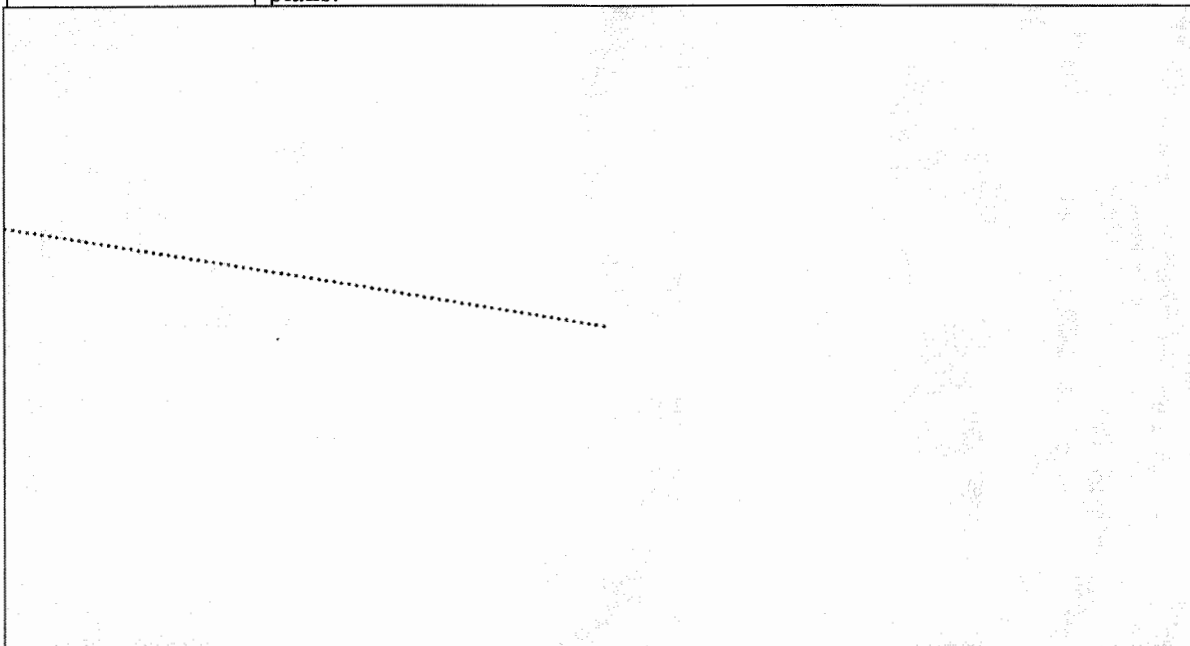
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February 1999

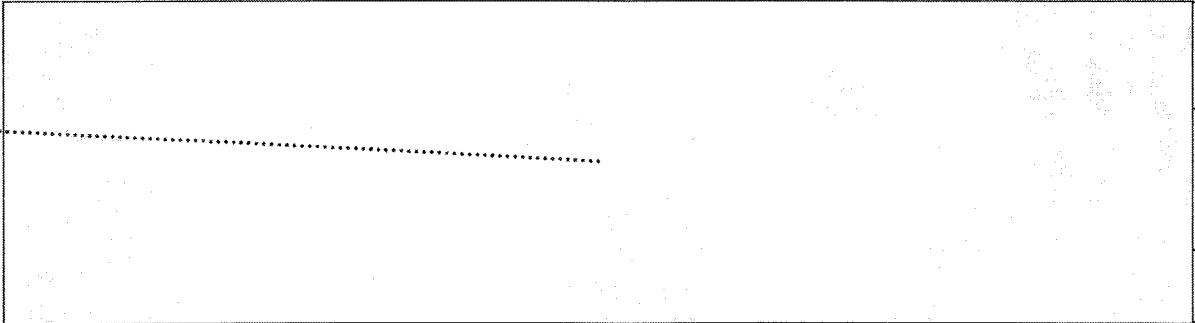
Creation of the Independent Review Process (IRP) is proposed as part of the Tax Exempt and Government Entities (TE/GE) Operating Division design plans.

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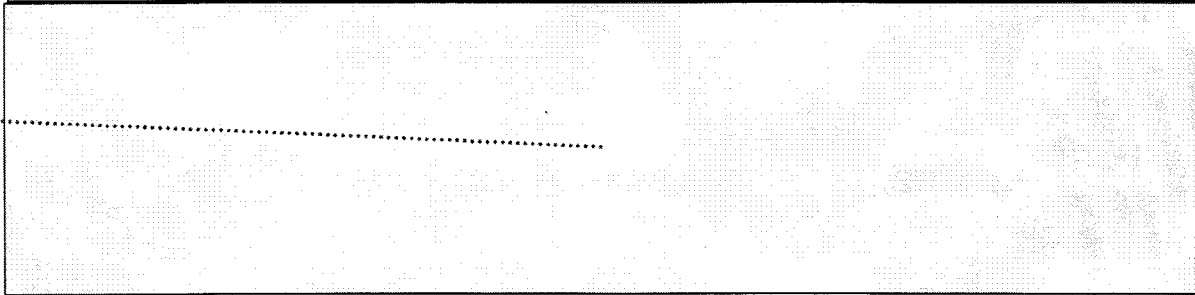
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March 2001

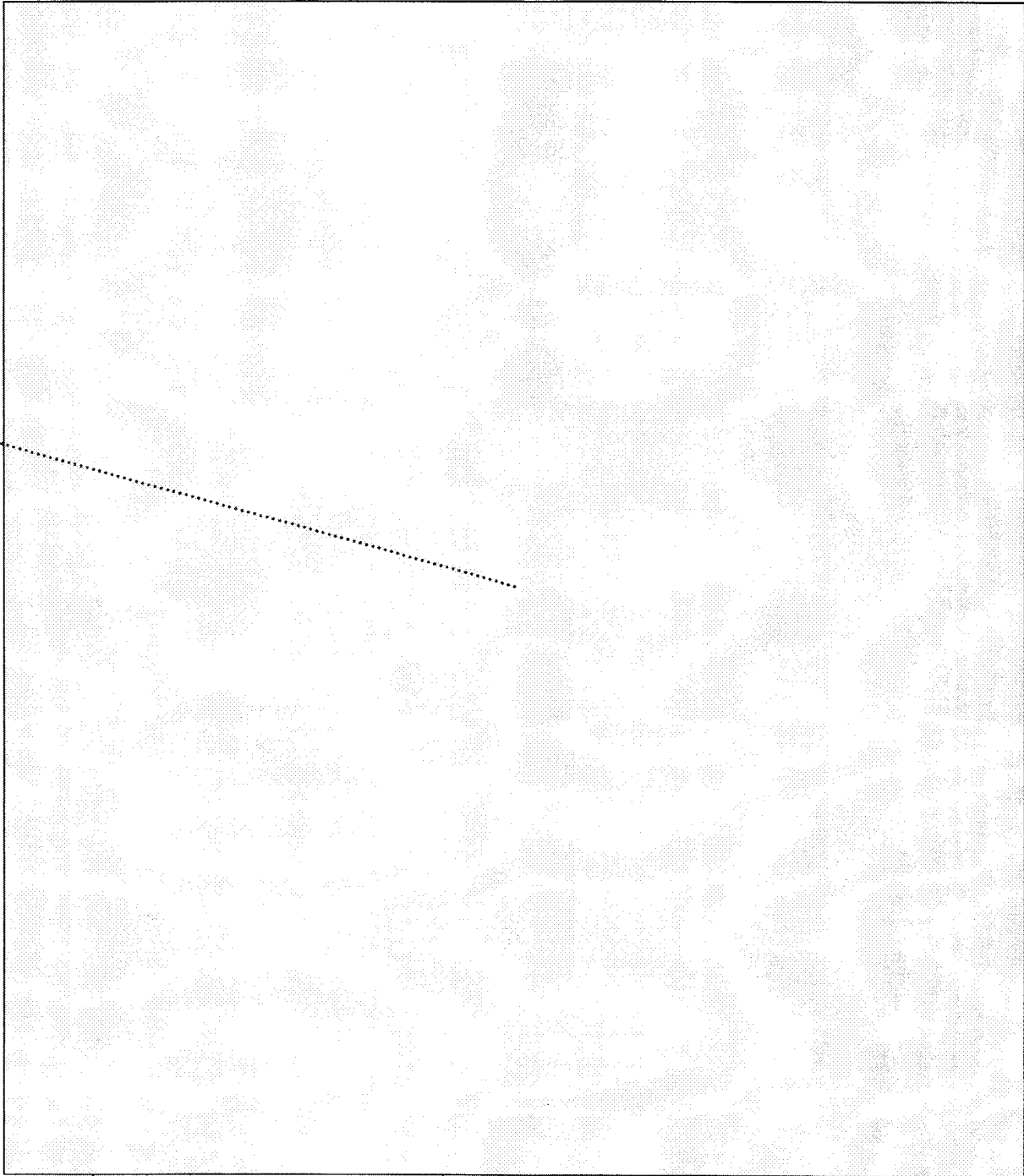
The position of Senior Technical Advisor (STA) is filled by the TE/GE Division.

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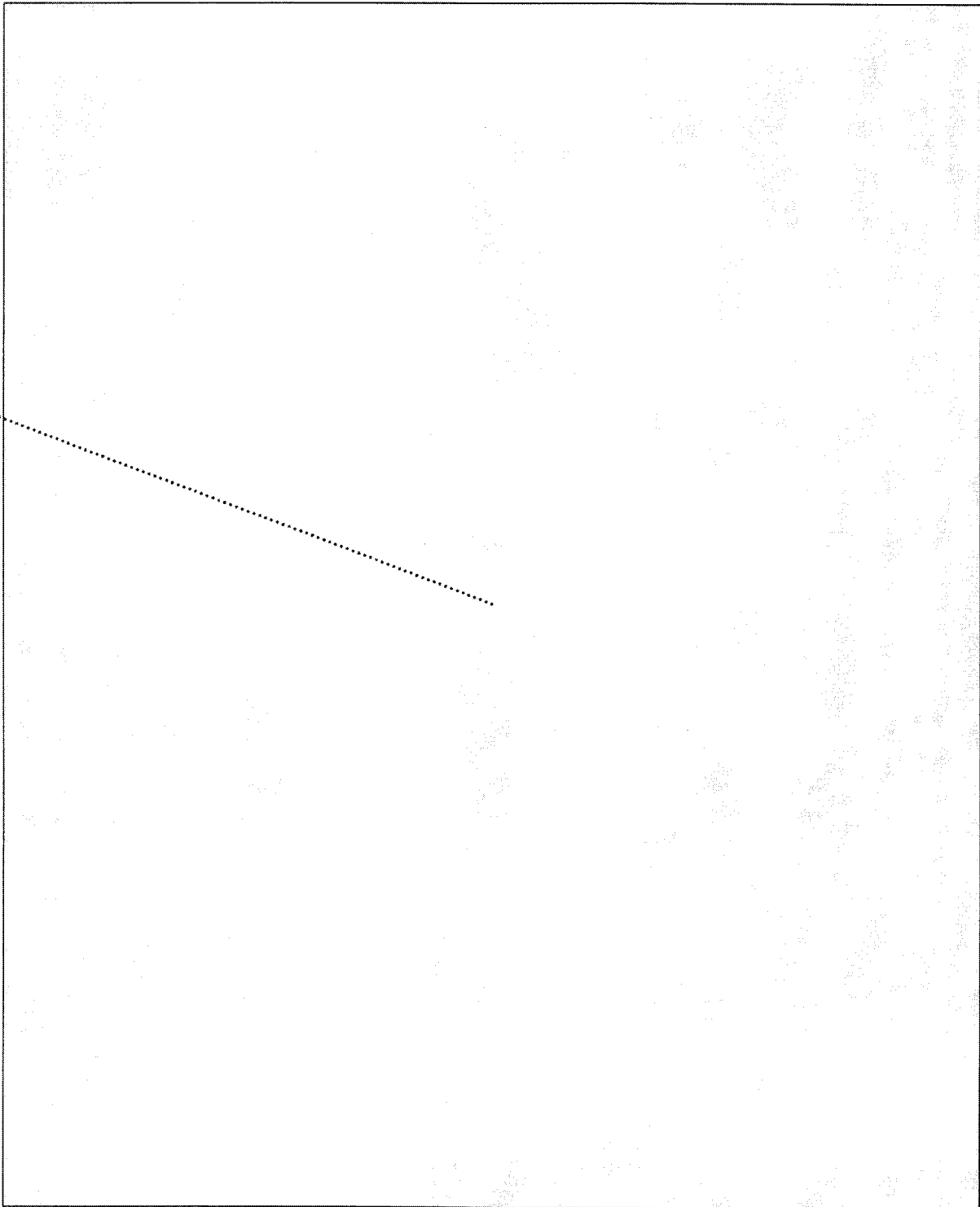
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Appendix V



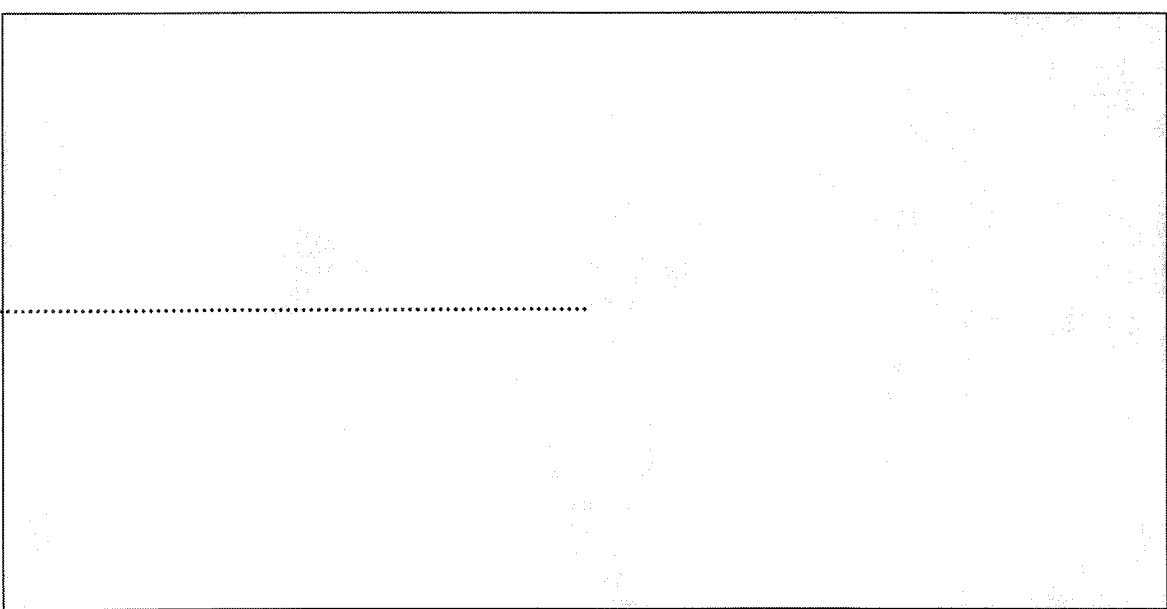
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Appendix VI

Management's Response to the Draft Report




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

RECEIVED

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MEMORANDUM FOR ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Evelyn A. Petschek 
Commissioner, Tax Exempt and Government Entities

SUBJECT: Response to Draft Audit Report: Review of the Tax
Exempt and Government Entities Division's Independent
Review Process (Audit 200310029)

At the outset, I would like to thank you and your staff for conducting this audit.

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I am grateful for the thoroughness of your review, and am gratified by the conclusions that you reached. I believe the corrective action you recommended was thoughtful and appropriate. The Tax Exempt and Government Entities Division intends to pursue it, although it may prove difficult for us to implement because the issue is technically hard and we cannot guarantee the concurrence of others who must also approve the guidance we publish.

Our comments on the recommendation follow:

IDENTITY OF RECOMMENDATION

The Commissioner, TE/GE Division, should prepare and submit for issuance public guidance to reemphasize the IRS's position on political activity and private benefit related to Internal Revenue Code section 501(c)(3) organizations.

CORRECTIVE ACTIONS

We will develop and submit to TE/GE Counsel and the Department of the Treasury the recommended public guidance. We note that the issue is difficult, and that the

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development of appropriate and effective guidance in this area is elusive. We also note that any guidance we submit will require the independent concurrence of TE/GE Counsel and the Department of the Treasury.

IMPLEMENTATION DATE

September 15, 2004

RESPONSIBLE OFFICIAL

Director, Exempt Organizations

CORRECTIVE ACTION MONITORING PLAN

The Director, Exempt Organizations, will report on the development of the guidance at monthly operational reviews with the Commissioner and Deputy Commissioner, TE/GE.