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# Advisory Committee on Tax Exempt and Government Entities (ACT)

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## Report of Recommendations



Department of the Treasury  
Internal Revenue Service

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Public Meeting  
Washington, DC  
June 8, 2005



**Advisory Committee on Tax Exempt and Government Entities (ACT)  
Public Meeting  
1111 Constitution Ave, NW  
Room 3313  
Washington, DC 20224**

**June 8, 2005**

**AGENDA**

- |               |   |
|---------------|---|
| 8:30 – 9:00   | Meet and Greet  |
| 9:00 – 9:30   | Welcome and Opening Remarks <ul style="list-style-type: none"><li>• Mark W. Everson, Commissioner of Internal Revenue</li><li>• Steven T. Miller, TE/GE Commissioner</li><li>• Sarah Hall Ingram, TE/GE Deputy Commissioner</li><li>• Steven J. Pyrek, Designated Federal Official of the ACT</li></ul> |
| 9:30 – 10:15  | ACT Overview Report and Summaries of Today's Recommendations <ul style="list-style-type: none"><li>• Victoria B. Bjorklund, Chairman of the ACT</li><li>• Project Leaders</li></ul>   |
| 10:15 – 10:45 | <i>Survey and Review of Existing Information and Guidance for Indian Tribal Governments</i><br>Lenor A. Scheffler, Project Leader   |
| 10:45 – 11:00 | BREAK   |
| 11:00 – 11:30 | <i>Tax-Exempt Bonds: Record Retention Burden</i><br>Terence P. Burke, Project Leader  |
| 11:30 – 12:00 | <i>Establishing the Enrolled Retirement Plan Agent Under Circular 230</i><br>Mary Beth Braitman, Project Leader   |
| 12:00 – 12:30 | <i>Project "IMPROVE": Improving Compliance of Newly Formed Charities</i><br>George A. Vera, Project Leader  |
| 12:30 – 1:00  | Closeout  |



**ADVISORY COMMITTEE  
ON TAX EXEMPT AND GOVERNMENT ENTITIES**

**2004-2005**

**Member Biographies**

**EMPLOYEE PLANS**

- **Mary Beth Braitman**, Indianapolis, IN

Ms. Braitman is a partner in the law firm of Ice Miller, where her clients include various governmental retirement systems in Indiana, Iowa, Kansas, Maryland, Massachusetts, Montana, Ohio, Oklahoma, Texas and Washington. She has worked extensively in pension and employment tax issues of state and local governments, Social Security coverage issues, and tax sheltered annuity programs in the kindergarten – grade 12 and university sectors. Ms. Braitman is a graduate of the Indiana University School of Law.

- **Michael P. Coyne**, Westlake, OH

Mr. Coyne is an attorney-at-law with Waldheger-Coyne. His practice focuses on tax, corporate and employee benefit issues of small employers and closely held businesses, with special emphasis on clients involved in healthcare. He presently represents approximately 350 qualified plans. He is a fellow of the American College of Employee Benefits Counsel. He holds a Juris Doctor in Law from Case Western Reserve University School of Law.

- **Douglas Kant**, Waban, MA

Mr. Kant is Senior Vice President and Deputy General Counsel at Fidelity Investments, where he works primarily with institutional retirement and employee benefits business units. He has a 25-year background in tax, ERISA and compliance aspects of qualified and non-qualified retirement plans of both for-profit and tax exempt sectors. He is on the Board of Directors of the American Benefits Council and holds a Juris Doctor in Law from the Boston University School of Law.

- **Charles M. Lax**, Southfield, MI

Mr. Lax is a partner and chairman of the Employee Benefits Group at his law firm, Maddin, Hauser, Wartell, Roth & Heller, P.C. His responsibility includes the representation of approximately 300 qualified retirement plans of all types and sizes. He authored numerous articles appearing in legal and public accounting journals and lectured extensively on qualified retirement plans and

other tax topics. Mr. Lax received his Juris Doctor from the University of Michigan.

- **Charles F. Plenge**, Dallas, TX

Mr. Plenge is a partner in Hayes and Boone, LLP and is Chair of its Employee Benefits/Executive Compensation Practice Group. His practice primarily involves a broad range of employee benefits and executive compensation matters on behalf of employers. Mr. Plenge received his Juris Doctor for the Southern Methodist University Dedman School of Law.

- **John W. Schroeder**, Los Altos, CA

Mr. Schroeder is in private practice, serving primarily small and medium-sized businesses. He has served nearly 20 years as in-house counsel in high technology companies, most recently as Senior Tax Benefits Counsel for Intel Corporation, and including service as Associate General Counsel to Advanced Micro Devices. He has served in the past on the board of the San Francisco Chapter of the Western Pension Conference and as President of the San Francisco chapter of the American Corporate Counsel Association. While he comes with primarily a large plan sponsor perspective, he also has experience working with small plans and can offer insight from their perspective. He is a cum laude graduate of the University of California, Los Angeles and received his law degree from the University of California, Berkeley (Boalt Hall).

## **EXEMPT ORGANIZATIONS**

- **Ann Western Bittman**, Washington, DC

Ms. Bittman is Vice President, Finance & Administration and Chief Financial Officer of the American Forest and Paper Association in Washington, D.C. and a member of the American Society of Association Executives (ASAE), where she has served in numerous leadership positions. She has over 15 years of experience in not-for-profit organizations and, because of her involvement in the association community, has had first-hand experience with many of the financial issues faced by tax-exempt organizations. She is a Certified Public Accountant (CPA), a Certified Financial Planner (CFP) and a Certified Association Executive (CAE). She holds a Bachelors degree in Business Administration from Georgetown University.

- **Victoria B. Bjorklund**, New York, NY

Ms. Bjorklund is a partner in the law firm of Simpson, Thacher and Bartlett LLP in New York, where her clients include educational organizations, museum, tax-exempt health care organizations and private foundations

involved in substantial domestic and international grant-making activities. She is a long-time active participant in the American Bar Association and the former Chair of the ABA Section Taxation-Exempt Organizations Committee. Ms. Bjorklund, a magna cum laude graduate of Princeton University, is a graduate of the Columbia University School of Law and holds a Ph.D. in medieval studies from Yale University.

- **Deirdre Dessingue**, Washington, DC

Ms. Dessingue is the Associate General Counsel of the United State Conference of Catholic Bishops in Washington, DC, and Co-Chair of the Religious Organizations Subcommittee of the American Bar Association Section on Taxation-Exempt Organizations Committee. Her experience as a practitioner reflects the broad range of concerns common to religious exempt organizations. She has particular expertise in the areas of prohibitions on political campaign activity, fund-raising limitations and unrelated business income. Prior to joining the staff of the U.S. Catholic Conference, Ms. Dessingue was a tax law specialist in the Exempt Organizations Division of the IRS. She is a graduate of the Catholic University College of Law.

- **Julie L. Floch**, New York, NY

Ms. Floch, with Eisner LLP, is the Director of Not-For-Profit Services and is the partner responsible for coordinating the planning and administration of engagements in the firm's not-for-profit practice. She is an adjunct professor of auditing at Baruch College/CUNY and teaches not-for-profit management at the New School University, as well as serving on its Faculty Senate. A graduate of the State University of New York at Binghamton, with graduate studies at Baruch College/CUNY, Ms. Floch has served on the influential Not-for-Profit Organizations Committee of the American Institute of CPAs and several of its successor task forces and is currently a member of the New York State Society of CPAs' committee on not-for-profit organizations (which she formerly chaired) and its committee on tax-exempt entities.

- **Suzanne Ross McDowell**, Washington, DC

Ms. McDowell is a partner at the law firm of Steptoe & Johnson LLP, where her practice focuses primarily on tax-exempt organizations. She has over 20 years experience working with nonprofit organizations. Prior to joining Steptoe & Johnson in September 2002, she was Senior Vice President and Deputy General Counsel at the National Geographic Society, Washington, DC. She also served as Associate Tax Legislative Counsel at the U.S. Department of the Treasury in the mid-1980s, and has prior private practice experience. She is active in the Tax Section of the D.C. Bar, the American Bar Association, and the American Society of Association Executives. She

received her A.B. from Smith College and her J.D., *magna cum laude*, from the George Washington University National Law Center.

- **George A. Vera**, Los Altos, CA

Mr. Vera is a CPA and the Vice President and Chief Financial Officer of the Packard Foundation, one of the largest private foundations in the nation. He is responsible for the finance and administration functions of the foundation, including investments, finance and accounting, information technology, facilities and grants management. He holds a Masters of Business Administration from Harvard University.

#### **GOVERNMENT ENTITIES: FEDERAL, STATE AND LOCAL GOVERNMENTS**

- **David Barrow**, Sacramento, CA

Mr. Barrow recently retired as Manager of the Tax Support Section of the California State Controller's Office, with over 31 years of state and local government experience spanning employment tax, reporting and Security Section 218 coverage. He is a member of the National Conference of State Social Security Administrators (NCSSSA) and is recognized as one of the most experienced and informed state officials in the nation in the area of federal employment tax coverage, withholding and reporting.

#### **GOVERNMENT ENTITIES: INDIAN TRIBAL GOVERNMENTS**

- **Robert L Gips**, Portland, ME

Mr. Gips is a practicing attorney, of counsel to Drummond, Woodsum & McMahon, specializing in the representation of Indian tribal governments and businesses. A major focus of his practice is tribal economic development. He has negotiated a number of the largest and most complex business and financing transactions done in Indian Country, including tribal acquisitions of operating businesses and creation of new tribal enterprises and joint ventures. Mr. Gips received his undergraduate degree from Harvard College and has a joint degree in law and business management from Yale Law School and Yale School of Management.

- **Lenor A. Scheffler**, Minneapolis, MN

Ms. Scheffler, a partner with Best & Flanagan, heads the firm's Native American Law Practice Group which represents a number of Indian tribes on tax, finance, business, and government matters. She has previously served as General Counsel and as Vice President of Corporate and Legal Affairs for tribes in Minnesota. She is currently the Chief Judge of the Upper Sioux



Community Tribal Court. Ms. Scheffler received her Juris Doctor from the William Mitchell College of Law.

## **GOVERNMENT ENTITIES: TAX EXEMPT BONDS**

- **Terence P. Burke**, Dallas, TX

Mr. Burke is a partner with the international accounting firm of Ernst & Young and serves as the National Director of Arbitrage Rebate Services for the firm. His expertise includes arbitrage rebate compliance, public funds investment, and local government investment pool services. Mr. Burke is a member of, and former advisor to, the Government Finance Officers Association and serves on the Board of Advisors of the Texas Tech University Southwest School of Governmental Finance. Mr. Burke is a licensed CPA.

- **Robert Donovan**, Providence, RI

Mr. Donovan is Executive Director of the Rhode Island Health and Educational Building Corporation. He is responsible for the operation of the state designated issuer of tax-exempt bond debt on behalf of private non-profit health care and educational institutions. He also serves on a number of boards and committees relating to tax-exempt bonds. Mr. Donovan holds a Certificate of Advance Graduate Studies in Finance, as well as an MBA from Bryant College.



## GENERAL REPORT OF THE ACT

This is the fourth public meeting of the Advisory Committee on Tax Exempt and Government Entities (the "ACT"). At these meetings, the ACT members have the opportunity to report to the Internal Revenue Service and the public on specific aspects of the TE/GE Division's interactions with its stakeholders. These reports take the form of specific recommendations to the Service. This year we have four reports on topics as varied as Indian Tribal Governments and record retention for tax-exempt bonds. The specific reports are:

- Survey and Review of Existing Information and Guidance for Indian Tribal Governments
- Tax-Exempt Bonds: Record Retention Burden
- Establishing the Enrolled Retirement Plan Agent Under Circular 230
- Project "IMPROVE": Informative Materials Prescribe Responsibilities and Obligations Very Early: Recommendations to Enhance the Compliance of Newly Formed Charities.

Looking back over the prior reports that have been presented in the previous public meetings, we believe that the evidence shows that the ACT has been able to offer a number of valuable recommendations to the Service. The value of the ACT's recommendations can be measured not by a subjective review of their content, but by the fact that the Service has elected to adopt and implement so many of them. We also believe the ACT represents true value added since ACT members are unpaid volunteers who bring expertise across all of TE/GE's areas of responsibility.

In addition, the ACT members serve as important links to the stakeholder public throughout the year when reports are being researched and written. In this role, ACT members may be asked to review and comment on working drafts of documents or forms. Sometimes this work occurs during working meetings at the Washington Post of Duty, but it also takes place in periodic conference calls and other informal contacts.

The ACT also facilitates communication with stakeholder groups. For example, during the past year ACT members made special efforts to reach out to the public for advice on a variety of topics. The feedback received is described in each of the ACT reports. In addition to gaining advice, these contacts remind the public of the role of the ACT. The current ACT members are gratified that so many members of the sector have applied for consideration for appointment to the ACT when its annual call for nominations is made. But the service that the ACT can provide is only as deep as the pool of the applicants who are willing to volunteer their time and expertise. Therefore, we on the ACT encourage everyone interested in the Service's leadership role in the sector to consider applying or to nominate a candidate.

This year also represents the end of the ACT's first life cycle. Specifically, the last of the original members of the ACT are rotating off, having served a full four years' service when the first start-up year and three working years are counted. They include:

- David Barrow, California State Controller's Office, Sacramento, CA
- Victoria B. Bjorklund, Simpson Thacher & Bartlett LLP, New York, NY
- Mary Beth Braitman, IceMiller, Indianapolis, IN
- Terence P. Burke, Ernst & Young LLP, Dallas, TX
- Deirdre Dessingue, US Conference of Catholic Bishops, Washington, DC
- John W. Schroeder, Santa Clara, CA

I know that my colleagues will join me in saying what a rewarding professional service the ACT has afforded us. As Chairman of the ACT, I would like to thank all of my colleagues for their contributions. I would also like to thank IRS Commissioner Mark W. Everson for his special interest in the ACT and its recommendations. I would like to thank IRS Chief of Staff Evelyn Petschek for her continuing support of the ACT. I thank TE/GE Commissioner Steven T. Miller and his directors, Carol Gold, Martha Sullivan, Preston Butcher, as well as Christie Jacobs and Mark Scott, for giving us their valuable

time and for their generous sharing of information to inform our reports. I thank Steven Pyrek for his organization and management skills as the ACT's Designated Federal Official. And I thank the many Service staff, including Brien T. Downing with the IRS Office of Professional Responsibility, who have been only too happy to meet with us to explain their jobs, to discuss the tasks which most challenge them, and to help us understand how we might all work together more efficiently and effectively toward realizing the goals in the TE/GE Division's Workplan. To succeed, the ACT clearly requires a partnership. We have enjoyed an extraordinary level of cooperation and goodwill and that has made our partnership valuable for all of us, and most importantly we trust, to improve compliance and enforcement in the sector.

Victoria B. Bjorklund  
Chairman



**Advisory Committee on  
Tax Exempt and Government Entities  
(ACT)**

***Survey and Review of Existing Information  
and Guidance  
for Indian Tribal Governments***

**Lenor A. Scheffler and Robert L. Gips, Project Leaders**

**JUNE 8, 2005**

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## **I. EXECUTIVE SUMMARY:**

There are over 560 federally recognized Indian Tribes in the United States. Each Tribe has its own government. The Tribal Governments, their tribal members, tribal government staff, financial officers, internal and external accountants, and internal and external lawyers who work with them are the customers (the "ITG Customers") of the Office of Indian Tribal Governments ("ITG"). The resources available to Tribes varies considerably. There are relatively few Tribes with sufficient resources to afford expert staff and counsel regarding tax matters. A great number of Tribes are not able to hire tax experts and must rely on generalists. At the same time, most Tribes are still in the early stages of tribal economic development and guidance on tax matters is particularly important.

An additional consideration is that Tribes have a unique status within our federal system as sovereign entities. The Federal Government maintains a government-to-government relationship with Tribes. Only a small number of federal officials have had the opportunity to be educated about tribal history, tribal status and tribal sovereignty, partly because of the unique nature of Tribes and their governments, partly because of a past history of official neglect (sometimes benign and sometimes not), and partly due to Tribes' historical lack of political power. Tribal governmental status often is not well understood, and consequently, tribal tax status is not well understood. In addition, a need for clarification remains in a variety of areas.

The recent recognition by the IRS of the need for the ITG and the ensuing creation and staffing of the ITG have been significant steps forward in turning the corner on this history of neglect, and on the lack of understanding of tribal tax and related issues. The ITG has recognized the importance of basic principles of tribal sovereignty and tribal outreach and has made great strides in its short existence. This progress is due both to the ITG's recognition of tribal sovereignty, and to the personal efforts of key ITG staff. The ITG has been viewed by ITG Customers as a positive initiative. The ITG has improved the lines of communication between Tribes and the IRS. This in turn has helped lead to a deeper mutual understanding between the ITG and Tribes. Information developed by the ITG, and the availability of ITG representatives to meet with Tribes, has led to an increased understanding of the IRS' requirements and undoubtedly has led to increased voluntary compliance.

However, while the creation of the ITG has been a significant step forward in creating usable and useful information for Tribes and enhancing compliance opportunities, as the ITG itself recognizes, substantial work in this area is yet to be done. To aid in this effort, our project has involved the following:

- Review areas where guidance is currently inadequate, including areas where guidance has been under review or promised.
- Review areas where new guidance is needed.

- Recommend action in these areas.
- Identify and review current sources of web-based information for ITG Customers, and recommend ways to enhance presentation of this material to ensure greater understanding of the current IRS policy.

In the course of our work, it became apparent that current enforcement efforts by the IRS -- some of which are viewed by Tribes as unfair and at odds with how the IRS treats state and local governments -- coupled with a lack of progress on promulgation of past promised guidance, threatens to undermine the positive work that has been done by the ITG. Our recommendations address this issue in hopes of preserving and enhancing the progress that has been made to date by the ITG.

## **II. PROJECT PROCESS:**

The Project Group began by gathering and reviewing available IRS published materials relating to Indian Tribes, including relevant Internal Revenue Code provisions, regulations, revenue rulings, revenue procedures, private letter rulings and technical advice memoranda. We also reviewed other IRS guidance products provided by the ITG, including publications, newsletters and other information. The Project Group also reviewed all material posted on the ITG's website, ranging from FAQ's to listings of relevant information.

Following this data collection and review, the Project Group undertook a variety of interactive data exchanges with representatives of ITG Customers. E-mails were sent to a sampling of ITG Customers, explaining the Project's scope and seeking written and oral feedback. Follow up conference calls were conducted with ITG Customers. Interviews were conducted by the Project Group in person and by conference call with members of ITG staff, the Chief Counsel's office, the Office of Tax Policy at Treasury, TE/GE website representatives, and representative national and regional tribal organizations. Throughout this process, the Project Group made recommendations to the ITG regarding its ongoing work to address issues of website design, content and guidance products.

### III. BACKGROUND:

As noted in the Executive Summary, promulgation of guidance for Indian Tribes and other ITG Customers historically has not been a focus of the IRS. A number of factors may account for this situation. First, the unique status of Tribes as governments is not well understood. Second, the Internal Revenue Code is often silent on essential provisions, leaving greater gaps than might be found in other areas. Third, many Tribes historically have been impoverished, with little or no economic activity occurring on Indian lands, thus muting the demand for guidance.

Unlike local, state and federal governments, Tribes do not have a tax base to support their government operations and general welfare programs for their tribal members. Much of Indian country<sup>1</sup> is held in trust and not subject to taxation. Tribes must look to business development and excess revenues from business enterprises to fund governmental operations and general welfare programs. There has been a long-standing Congressional policy encouraging economic development in Indian country<sup>2</sup>, and over the past fifteen years an explosion in the pace of economic development has occurred for a number of Indian tribes. This is a welcome trend for communities that historically have been marred by some of this country's worst poverty, unemployment rates, lack of adequate housing, and poor infrastructure.

Unfortunately, the issuance of guidance by the IRS has not kept pace with the speed of economic development initiatives occurring in Indian country. This has been a source of frustration and even anger, cited to our Project Group during interviews and surveys. Tribal governments are hampered by inadequate guidelines available to assist Tribes in understanding the federal income tax consequences of using various business structures. For example, no guidance exists concerning the tax consequences of using a tribally-owned, state chartered limited liability corporation, or a tribally-owned, tribally chartered limited liability corporation, or a tribally-owned, tribally chartered corporation. Such basic questions are particularly important for Tribes, because tribal governments tend to be the primary source of economic development for Tribes, and hence the major source of employment and income opportunities for tribal members and their families.<sup>3</sup>

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<sup>1</sup> Indian country generally refers to territory under the jurisdiction of an Indian tribal government, and is statutorily defined at 18 U.S.C. §1151.

<sup>2</sup> See Indian Employment, Training and Related Services Demonstration Act of 1992 [Pub. L. 102-477](#), Oct. 23, 1992, 106 Stat. 2302 (25 U.S.C. 3401 et seq.); Indian Gaming Regulatory Act [Pub. L. 100-497](#), Oct. 17, 1988, 102 Stat. 2467 (18 U.S.C. 1866–1868; 25 U.S.C. 2701 et seq.); Indian Self-Determination and Education Assistance Act [Pub. L. 93-638](#), Jan. 4, 1975, 88 Stat. 2203 (25 U.S.C. 450 et seq.); Native American Business Development, Trade Promotion, and Tourism Act of 2000 [Pub. L. 106-464](#), Nov. 7, 2000, 114 Stat. 2012 (25 U.S.C. 4301 et seq.); and Native American Housing Assistance and Self-Determination Act of 1996 [Pub. L. 104-330](#), Oct. 26, 1996, 110 Stat. 4016 (25 U.S.C. 4101 et seq.).

<sup>3</sup> Tribes, similar to other governments, exist in large part to provide services to the community -- direct services to constituents, infrastructure services and administrative services. The difference is that Tribes increasingly rely on economic development to fund those governmental services

The IRS has publicly stated for nearly a decade that initiatives to provide guidance in this area were under study or actively under study<sup>4</sup>, but there is a marked lack of tangible progress.

The nature of ITG Customers differs from that of other IRS customer groups. The tribal tax world is not a known environment like that encompassing exempt organizations or employees plans. There is not an army of specialists who know the clear parameters and can advise or advocate for their clients. Only a few Tribes have staff with professional tax experience, and there are literally only a handful of lawyers who have been able to focus their practices on tribal tax matters. The fact is that most Tribes are advised by generalists -- whether lawyers, accountants, or tribal employees. This state of affairs underscores the need for the IRS to provide ITG Customers with clear and useful guidance. Furthermore, because there is a significant diversity of technical understanding among ITG Customers, the IRS must be able to meet the information needs of ITG Customers with both basic and advanced understanding of tax issues. As Congress has mandated legislatively in recent decades, the goal should be to help all Tribes achieve 'self determination' – the right and power to manage their own affairs and to exercise their sovereignty.

The IRS' mandate to provide such guidance to Tribes is also underscored by the unique trust relationship that the Federal Government has with Indian Tribes. This relationship includes trust asset management responsibilities, whereby the United States has the responsibility of acting as trustee for vast amounts of Tribal assets and individual tribal members' assets. This fiduciary responsibility has, to the great discredit of our country, been breached for over a hundred years; Cabinet officials have repeatedly been held in contempt of court for this breach in recent years.<sup>5</sup> This trust responsibility also extends to the more inchoate responsibilities of the Federal Government to act on behalf of Tribes.<sup>6</sup> The trust responsibility forms an additional backdrop through which Tribes view the IRS's actions, and against which the IRS's actions will be measured.

Within this atmosphere of increasing Tribal economic development, and lacking guidance from the IRS, the general view of many ITG Customers that were interviewed

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(supplemented with tribal taxes and other fees if available), while states and municipalities generally rely on their larger land and population bases to assess taxes (income, sales and property) to support services, supplemented by other fees and its own economic development initiatives. The need for Tribes to self-fund governmental services has accelerated as federal funding for Tribes has come under greater pressure in recent years.

<sup>4</sup> See the general discussion of the history of such initiatives at pp. 10-11.

<sup>5</sup> See *Cobell v. Norton*, U.S. District Court declaring Interior's conduct in managing trust assets and responses to class action suit as "the most egregious governmental misconduct it has ever seen". 2002 WL 163465 at \*35.

<sup>6</sup> See generally F. Cohen, Handbook of Federal Indian Law 220-228 (1982) (Cohen). [United States v. Mitchell](#), 463 U.S. 206, 225, 103 S.Ct. 2961, 2972, 77 L.Ed.2d 580 (1983); [Tulee v. Washington](#), 315 U.S. 681, 684-685, 62 S.Ct. 862, 864, 86 L.Ed. 1115 (1942); [Cherokee Nation v. Georgia](#), 5 Pet. 1, 17, 8 L.Ed. 25 (1831)

was a sense of frustration and even anger at the slow pace of IRS follow-through on existing guidance projects.<sup>7</sup> These feelings were heightened by the belief that while the IRS has failed to deliver promised guidance, it has been seen to be increasingly focused on enforcement. New resources are perceived to have been devoted to enforcement efforts, rather than delivery of the promised guidance. This perception is only reinforced by current ITG work plans and overall TE/GE new hiring which is focused on enforcement efforts, and recent announcements regarding enforcement efforts.<sup>8</sup>

We learned from our discussions with TE/GE staff, Chief Counsel's Office and Treasury that there are several factors which underlie the slow pace of producing new guidance. These include: lack of resources; the complexity of issues presented; concern about precedential effect in seemingly unrelated areas; and the fact that the TE/GE group is only one of the relevant members of the IRS working groups that must ultimately reach consensus on new guidance. It is clear that new guidance will involve complex considerations and will require careful deliberation.

Nonetheless, we think that it is equally important for TE/GE to recognize the frustration felt within Tribes over such delays, which is heightened by a sense among ITG Customers that (i) the IRS is increasingly focused on enforcement rather than guidance, and (ii) what little recent guidance has been issued has been perceived by ITG Customers as unfair to tribal governments (because either the IRS does not understand tribal governments or it wants to treat them as non-profit entities and not true governments, e.g., treating tribes differently than governments that construct and operate golf courses and hotels with tax-exempt financing).

Furthermore, some interviewees, including influential tribal advocates, expressed concern that the consultation process is merely a façade, and that “compliance check” meetings currently being conducted by ITG are thinly disguised fishing expeditions for enforcement opportunities. More fuel is added to these fires by the lack of a signed consultation policy.

These experiences and this perception undermine the good work that ITG has done in its first few years of existence.

The ACT thus believes that a renewed emphasis on promptly completing existing guidance projects is critical and in the best interests of both Tribes and the IRS. The ACT also believes that such an emphasis is inherent in the trust relationship. We believe further that greater transparency in the process of creating guidance, and

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<sup>7</sup> In addition to the discussion of the history of promised guidance regarding the tax consequences of various legal structures for tribal economic development entities *infra* at pp. 10-11, *see also* discussions *infra* at p. 11 regarding promised guidance regarding tribal trusts and at p. 12 regarding lack of guidance on tax exempt tribal financings.

<sup>8</sup> *See* Bond Buyer, v. 352, April 28, 3005, 2005 WLNR 6999635 (discussing IRS announcement of plans to institute a dozen or more new examinations of Tribes to see if any transactions involved abusive arbitrage devices).

greater understanding of the issues faced by the IRS in creating such guidance, is necessary. Accordingly, the ACT is making several recommendations regarding these aspects of the guidance process.

The ACT also believes that continued focus on dissemination of existing information is important. ITG has made a good start through the ITG web site, and we believe this is an area meriting further focus and work.

## IV. RECOMMENDATIONS AND DISCUSSION:

### A. Guidance Recommendations

As discussed above, there are several core subject matter areas where ITG Customers have been promised but not received guidance. These include the following:

**Recommendation #1: Issue guidance regarding the federal tax treatment of different legal structures used for tribal businesses and economic development entities.** As noted earlier, Tribes generally do not have tax revenues adequate to support government operations, and many tribal members depend on tribal general welfare programs for housing, health care and elder care, as well as, tribal businesses for job training and employment. Excess revenues from tribal business operations are a critical source of funding for tribal governmental programs, but guidance on the income tax consequences of alternate business structures has been minimal. The IRS has provided very limited guidance in the past on this matter, despite the fact that further guidance on this matter has been a matter of official study and consideration for nearly a decade. As noted earlier, tribal governments are the primary engine for economic development in Indian country, lending urgency to the need for this guidance.

**Observation:** Limited guidance exists at this point. Tribes are not taxable entities, though most tribal income, when distributed to tribal members, is subject to individual income taxation.<sup>9</sup> The IRS has ruled that if a Tribe forms a wholly owned corporation under state law, the corporation is subject to federal income tax.<sup>10</sup> It is also clear that Tribes may form wholly owned, federally chartered “Section 17” corporations under the Indian Reorganization Act, 25 U.S.C. §465, and that such corporations are not subject to federal income tax.<sup>11</sup> Section 17 corporations, however, can take months to establish, their charters cannot be amended without federal approval, and their status is confusing to third parties. Tribes urgently need guidance on the IRS’s view of the income tax consequences of Tribes conducting business through wholly owned corporations and limited liabilities companies formed under tribal law, and on the status of wholly owned limited liability companies formed under state law.

For ITG Customers, the length of time that this issue has been under consideration, without issuance by the IRS of precedential guidance, is a source of extreme frustration. In the preamble to the final regulations on the tax classification of business entities in 1996, the IRS noted that the Treasury Department and the IRS were considering the status of wholly owned, tribally

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<sup>9</sup> Rev.Rul. 67-284, 1967-2 C.B. 55.

<sup>10</sup> Rev. Rul. 94-16., 1994-1 C.B. 19.

<sup>11</sup> Rev.Rul. 81-295, 1981-2 C.B. 15; *see also, Mescalero Apache Tribe v. Jones*, 411 U. S. 145, 157 n. 13 (1973). These federal law corporations are referred to as Section 17 corporations because they are incorporated pursuant to Section 17 of the Indian Reorganization Act.



chartered corporations.<sup>12</sup> Subsequently, in 2001, the Treasury Department and the IRS agreed to resolve questions regarding such tax treatment. This matter has been on the IRS work plan for years, with no apparent progress toward resolution.

Discussions with ITG, Chief Counsel's Office, and Treasury indicated that this was considered to be a complex matter involving the possible creation of precedent for other governmental entities. Given the unique status of Indian Tribes, the Project Group is uncertain why guidance in this area necessarily needs to be considered precedent-setting in other areas, and we urge further consideration of the weight granted to this concern.

Additionally, the Project Group believes that this area might be one where, if comprehensive guidance is not likely to be readily forthcoming, the IRS should consider issuing limited guidance addressing more discrete elements of the various possible structures that Tribes might use for economic development.

The continued absence of guidance in this critical area hampers vitally needed tribal economic development.

**Recommendation # 2: Issue guidance regarding tribal trusts.** The IRS has provided limited guidance to Tribes on the issue of the tax treatment of tribal trusts. Revenue Procedure 2003-14 provided guidance on the income tax consequences applicable to trusts established by Tribes using gaming revenues for the benefit of minors and incompetent persons. That Revenue Procedure also requested public comment and set out a no-rule position on private letter ruling requests while the comments were being considered. Significant public comments were received. However, no action has been taken on the comments received, and because of the Service's no-rule position, Tribes are not able to get any guidance whatsoever, even in the form of private letter rulings.

**Observation:** Despite the fact that Rev.Proc. 2003-14 addressed minor and incompetent trusts, the no-rule issued by the IRS was drafted so broadly that it encompasses most other trust rulings a tribe might request, including those related to adults. Many Tribes have been forming a variety of trusts over the past few years, and the IRS's inaction is another source of frustration for Tribes. Additionally, the inaction of the IRS on the comments received to date and the no private letter ruling position have created an environment in Indian country for tax avoidance schemes and unscrupulous promoters. Such an environment undermines the IRS's current emphasis on curtailing abusive schemes. As promised, comments on Rev. Proc. 2003-14 should be incorporated into a new Revenue Procedure, and in the interim, the no-rule position should be rescinded

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<sup>12</sup> See Treas.Dec.869, 61 Fed.Reg. 66585 (Dec. 1, 1996)

by the IRS. Such action will further the IRS's stated goal of discouraging and deterring misuse of government entities by third parties.<sup>13</sup>

**Recommendation # 3: Issue guidance regarding what constitutes an “essential governmental function” for purposes of tribal government issuance of tax-exempt debt.** This issue was the subject of an ACT report last year entitled *Tribal Guidance and Policy*.<sup>14</sup> As that ACT Report noted, governmental bonds issued by Tribes are an essential tool for creation of tribal infrastructure. Tribes may not issue private activity bonds, but tribal governments may issue tax-exempt bonds for “essential governmental functions.” Unfortunately, the meaning of that term remains unclear. Without reprising the issues addressed in that Report here, these issues continue to fester, and frustration within the tribal governmental community continues to grow as the IRS has significantly expanded the number of Tribes under audit as issuers or borrowers of tax-exempt debt.

**Observation:** When amending the Indian Tribal Government Tax Status Act in 1987,<sup>15</sup> the Report of the House Committee stated that “the term essential governmental function does not include any governmental function that is not customarily performed (and financed with governmental tax-exempt bonds) by States and local governments with general taxing powers.”<sup>16</sup> As noted in *Tribal Guidance and Policy*, since 1987 no regulations have been issued on this point, nor has further guidance been provided, other than Field Service Advice 2002412 (the “FSA”) issued on November 22, 2002. This FSA determined that although there were 2,645 publicly owned, municipal golf courses in the country, a financing of a tribally owned golf course would not qualify as an essential governmental function, and the IRS has commenced audits of at least two tribal issuances of tax-exempt bonds intended to finance public golf courses.<sup>17</sup> Within the tribal government community, this FSA and audits continue to cause consternation and a sense of bias. And while states and cities routinely issue tax-exempt debt for hotels and convention facilities, the IRS has commenced initial audit proceedings regarding several recent instances of conduit bonds issued by non-tribal entities for the benefit of Tribes constructing hotel and meeting facilities in Indian country.<sup>18</sup> These audit actions collectively have had a perhaps intended chilling effect on issuance of tax-exempt tribal debt, and at the

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<sup>13</sup> One of the four “key enforcement priorities” in the IRS Strategic Plan is to “discourage and deter non-compliance within tax-exempt and government entities and misuse of such entities by third parties for tax avoidance and other purposes.” IRS Strategic Plan, <http://www.irs.gov/newsroom/article/0,,id=125266,00.html>.

<sup>14</sup> *Tribal Guidance and Policy*, ACT Report, June 9, 2004. See <http://www.irs.gov/charities/article/0,,id=98353,00.html> at 97 *et .seq.*

<sup>15</sup> Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, 96 Stat. 2608, 256 U.S.C. § 7871.

<sup>16</sup> H.R. Rep. No. 391 at 1139.

<sup>17</sup> See Bond Buyer, *supra*.

<sup>18</sup> *Id.*

same time have reinforced sentiments of bias among Indian tribal governments and their advocates.

Comment: We recognize that actions in this area by the IRS are circumscribed by the fact that the best solution to this issue – issuance of regulations by Treasury – is not within the IRS' control; and by the fact that enforcement actions are proceeding. But guidance in this area has reverted to guidance by field examination and audit. Enforcement is not a substitute for guidance, and the ACT believes that Tribes need and deserve guidance promptly.

**Recommendation #4: Provide more consistency, transparency and communication to the tribal government community and leading advocates regarding the guidance process.** Through our discussions with ITG representatives, Chief Counsel's Office, and Treasury, the Project Group became more aware of some of the limitations placed upon the ITG and the TE/GE group in attempting to provide guidance on some of the foregoing issues. We are aware of the fact that many issues require input from groups outside TE/GE, including other subject matter groups within the IRS, and from agencies outside the IRS. Despite these issues, the Project Group recommends that ITG, Chief Counsel, and the TE/GE group redouble their efforts to gain cooperation needed to address the foregoing guidance issues. At the same time, we believe that efforts to explain the guidance process to ITG Customers – including both procedural issues and substantive concerns -- will be helpful to both the IRS and ITG Customers, and are worth undertaking. This can be done through attending and speaking at one or two national tribal gatherings, and through an annual invitation to tribal advocates to meet with relevant IRS officials in Washington for more informal discussion of open issues.

Observation: As noted before, even though ITG has done an excellent job of reaching out to Tribes, there is a perception among ITG Customers that the ITG has little control or power over the guidance process, and that the process of guidance formulation is a black hole of uncertainty. There is minimal awareness, at best, of who is responsible for tribal guidance, where various projects stand, what the timetables for completion are, and what some of the competing substantive concerns of the IRS might be. While discussions with Chief Counsel revealed that several individuals tend to be involved in most tribal guidance decisions, this is not generally known. We would recommend that several people within Chief Counsel's Office be assigned the responsibility of developing familiarity with Indian law and serve as liaison for tribal guidance efforts. Treasury has an individual who serves as a liaison for guidance efforts. This is commendable.

## **B. Website Recommendations**

ITG's website is an important source of information for Indian country. We like the fact that it is an independent landing page, reflecting ITG's logo. We understand from meetings with those responsible for the page that ITG has a limited number of

options in changing the layout of the page. We also understand that this is due to a desire within the IRS for consistency of layout.

The widely dispersed geographic nature of Indian Tribes, and the fact that the ITG Customers are not served by a large corps of tax specialists illustrates the importance of the website for information dissemination. It also explains why the website needs to be user-friendly, comprehensive, and as current as possible. ITG's website reflects considerable past work and thought, but could be improved in several ways.

**Recommendation # 5: Develop a comprehensive, easily-locatable, and cross-referenced set of all statutes, regulations, revenue rulings and other guidance related to Indian tribal governments.** As of this writing, there remains no single, comprehensive and accurate source of the IRS' tribally-related materials that can be easily referenced by tribal officials and practitioners. Ideally, such a source should be compiled in two, hyper-linked formats: first, a listing of relevant materials by statute, regulation, revenue ruling, revenue procedure, field guidance, private letter rulings, and so on, listed from most precedential to least, with a brief summary description of the subject matter of each document; and second, by subject matter.

Observation: There are literally only a handful of tribal tax professionals who have easy access to the full panoply of IRS rulings affecting Tribes. ITG Customers are not likely to subscribe to tax publications or have access to specialized materials. While there are many helpful FAQ's on the website, there is a great need for one place where ITG Customers can easily find all relevant materials. The current ITG website aggregates some of this material, but the site is incomplete, and hard to locate. To find the ITG page that only partially aggregates these materials, one must navigate to [irs.gov/tribe](http://irs.gov/tribe), go to "related topics", click there on "more topics", and scroll down to "regulations and rulings" – a confusing set of steps that is not intuitive. Instead, we recommend that, as is done on the Tax Exempt Bond Community landing page, there be a permanent link to 'Published Guidance' on ITG's landing page.

Comment: This recommendation has been discussed since fall 2004 with ITG, which agrees with the concept and has been working to gather and organize relevant materials for posting. We encourage ITG to complete this work as quickly as possible and post it in the recommended format.

**Recommendation # 6: Post on the ITG website a detailed explanation in plain English of the hierarchy of guidance, in terms of binding precedential value.** We envision this explanatory piece as a sort of "Layman's Guide To Guidance" or "Guidance Matrix" or "Guidance Flow Chart" accompanying the cross-referenced set of statutes, regulations and other guidance discussed in Recommendation #5, with such materials explaining, for instance, the difference between revenue rulings and private letter rulings, which guidance is binding, and which advisory.

Observation: Due again to the number of website ITG Customers who are not tax professionals, such an explanation would be extremely helpful, and we believe that its creation should not require extensive resources.

**Recommendation # 7: Consider creative ways to update and improve the various FAQs that appear on the website.** There are numerous FAQ sections within the website, which contain a wealth of information for ITG Customers who are trying to understand issues relating to Tribes and tribal taxation. Much of this information was created a number of years ago, upon the inception of the ITG. Some of the information is internally inconsistent (for example, different definitions of items in various FAQs), some information is outdated, and some information is factually incorrect. In addition, hyper-links need to be increased. In an ideal world, there might be staff within ITG available to review, revise and update the FAQs. If, however, this is not the case, alternative approaches should be considered for assistance. One promising possibility would be to work with one or several law schools that have Indian law programs, and ask for student volunteer assistance, coordinated through law professors, to revise and modernize the FAQs. The ITG would then be tasked with reviewing and finalizing new or revised content, but would be saved a good deal of labor.

Observation: Members of the Project Group have had initial conversations with Indian law professors at several law schools, and believe that there would be significant interest in such a project.

**Recommendation #8: Reorganize ITG's landing page so that the topics addressed in the body of the page serve as guidelines to the places where relevant content can be found.** As currently organized, there is no apparent rationale to the topics on the landing page, which appear to cycle on and off with the most recent developments being listed, and earlier developments being displaced accordingly. Instead, we recommend that current developments be listed under a heading with that title; that published guidance be similarly listed under a heading with that title; and so on.

Observation: The Project Group believes that a good template for such organizational change can be found in the Tax Exempt Bond Community landing page, and this should be emulated.

**Recommendation # 9: Provide a direct link to ITG's web page from the general IRS landing page.** The rationale for such a link is fairly straightforward. Most people trying to access IRS tribal information do not and will not know of the ITG web page. Most people landing on the main IRS web page most likely will not know that Indian Tribal Governments are part of "Government Entities". Others may search from the main IRS landing page in the search box. With three separate samplings, ITG's website is not one of the initial items that came up. Specifically, if "Indian Tribes" is typed in the search box, there are 376 results that include FAQs but none take you straight to ITG's web page. If "Indian Tribal Government" or "Tribal Government" are typed into the search box on the main IRS landing page, there are 500 results to search through and

no link to the ITG. If “Indian” is typed into the search box on the main IRS landing page, there are 35 results and, again, none take you to the ITG’s web page. Therefore, having a direct link to the Indian Tribal Government page would be a tremendous tool for ITG Customers.

Observation: The ACT believes that the rationale for providing this link is similar to that which justified adding a similar link on the IRS.gov landing page to the tax exempt bond web page. Additionally, revising the IRS.gov landing page to list “Federal, State, Local and Indian Tribal Government Entities” would be more helpful than just “Government Entities.” This is an easy short-term solution.

**Recommendation # 10 : Allow more creativity in the design of the ITG web page.**

The recommendations of the ACT regarding ITG’s web site layout have been constrained by what we have been told are limits on the appearance of the ITG’s web pages intended to promote uniformity in appearance of all IRS web pages. While we understand the desire for uniformity, we believe that the needs of ITG Customers differ so greatly from the needs of users of other IRS web pages aimed at individual taxpayers, that it makes more sense to allow greater creativity in design of ITG’s web page. We believe that the likely outcome will be web pages better designed to meet the needs of the different taxpayer groups, and this in turn will promote greater use of the web pages with the concomitant benefits of increased, low-cost information dissemination and greater compliance.

Observation: The concern for uniformity, we believe, should not stifle creativity; and one could still envision a system where deviations from the current page design need central approval, in order to avoid gross inconsistencies. If there is concern about the effect of undertaking such a change all at once, an alternative would be to allow experimentation by one or two relevant groups, including ITG.

## **V. CONCLUSION**

We appreciate the time and support of ITG staff, Chief Counsel’s office, the Office of Tax Policy at Treasury, TE/GE website representatives, as well as the time and comments of all those Tribal representatives and advocates who shared their views with us.

The recommendations and views set forth herein are offered in the belief that the good work to date that has been accomplished in creating ITG will be enhanced through provision to Tribes of prompt promised guidance and improvements to the ITG website. These steps will enhance compliance opportunities and improve the relationship between ITG and ITG Customers.

**Advisory Committee on  
Tax Exempt and Government Entities  
(ACT)**

**Tax Exempt Bonds:  
*Record Retention Burden***

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David H. Barrow**

**JUNE 8, 2005**

**TAX EXEMPT BONDS:  
RECORD RETENTION BURDEN**

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# EXECUTIVE SUMMARY

Issuers of tax-exempt bonds are facing a serious and expanding burden concerning record retention. This burden centers on two facets: very little published guidance on the format or types of documents to be retained and the length of the retention period that must be met to facilitate tax compliance administration. Presently, the tax-exempt bond market represents a total outstanding value of \$2.0 trillion.

In a tax-exempt bond transaction, the issuer of the bonds is not the taxpayer. In the event of a determination of taxability, the bondholders are responsible for the payment of taxes, not the issuer of the bonds. However, bondholders generally do not maintain any information to assist in the examination process. Instead, the issuer or the conduit borrower maintains all the records and legal documents relating to the bond transaction and the use of the bond proceeds.<sup>1</sup> Note: In certain instances, the conduit borrower is also treated as the taxpayer, pursuant to the provisions of IRC Section 150(b).

Unlike most taxpayers where the overall examination life cycle is relatively short (e.g., three years after the filing of a Form 1040), the life cycle of a bond issue can be extremely long. A majority of tax-exempt bonds are issued to finance projects with a long useful life such as roads or schools. And it is common for a bond issue to be sold with a final maturity of 30 years. In addition, if a bond issue is refinanced by another bond issue (refunding), the record retention requirements of the original bond would need to continue for the entire life of the refunding bond issue. Therefore the final maturity of a typical bond issue creates a unique record retention burden since the possible examination period spans several decades.

Issuers of tax-exempt bonds are required to retain all records related to the investment and expenditure of the gross proceeds of the bond issue. Given the fact that many municipalities include multiple projects in a single bond issue, the volume of underlying invoices and investment records can be considerable. Also, issuers of tax-exempt bonds which sell bonds for conduit borrowing issues on a frequent basis may issue twenty or more issues annually, with the cumulative retention of all related records becoming staggering.

The tax-exempt bond community and the IRS Advisory Committee for Tax-Exempt/Government Entities (ACT), via this report, have acknowledged that a fundamental review of existing retention requirements and modification to those requirements are necessary. These parties agreed that all recommended modifications must embrace the concepts of reducing administrative burden while insuring adequate IRS audit controls.

**PROJECT STATEMENT:** Reduce administrative burden for tax-exempt bond issuers of maintaining tax-exempt bond documentation while adequately insuring timely and cost effective federal tax compliance.

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<sup>1</sup> Excerpt from Advisory Committee on Tax Exempt and Government Entities report on *Audit Cycle Time and Communications* dated June 9, 2004.

**SCOPE:** Review of existing regulatory and administrative tax-exempt bond document requirements along with current business practices and document use cycles.

**METHODOLOGY:** The team approached this project through a variety of information gathering methods including direct interviews with representatives of affected entities of the tax-exempt bond community and IRS. The principals included issuers and industry organizations, as well as several staff members of the Office of Tax-Exempt Bonds (TEB). The underlying review sought to identify all necessary documents and their current retention requirements. The team reviewed other business organizations and industry best practices to determine if any opportunities were applicable to tax-exempt bonds.

The team considered bond-based documents with respect to use, ownership, value to IRS audit practices and known/projected transactional needs. This review sought comparisons between TEB-based IRS informational needs versus other programs applying mandated IRS retention requirements. The underlying premise was to determine what, if any, practices associated with other IRS stakeholder communities could be applied to the tax-exempt bond environment.

**DISCUSSION:** The tax-exempt bond environment is an extremely complex financial platform. The environment is comprised of a vast array of bond-financed projects and related tax rules, extensive arbitrage yield restrictions/rebate parameters as well as highly detailed allocation and investment valuation issues. Tax-exempt bond participants are also experiencing an increasing IRS enforcement presence. A pivotal issue, for IRS and the tax-exempt bond community alike, is the issue of tax-exempt bond record retention. In many instances, records related to the bond issue may be deemed maintainable for in excess of 30 years. The following recommendations offer pragmatic and workable alternatives to the existing document retention practices. We believe these alternatives satisfy both IRS and the tax-exempt bond community's vested interests.

#### **RECOMMENDATIONS:**

- **Recommendation:** The Service should develop a revenue procedure providing guidance on the types of records that issuers of tax-exempt bonds should retain and the related time period for retention of those records.
- **Recommendation:** The Service should establish a special exception for governmental and Internal Revenue Code (IRC) 501(c)(3) bond issuers that will ease the burden of recordkeeping with respect to the arbitrage rebate requirements of IRC Section 148(f)(2).
- **Recommendation:** The Service should re-evaluate the merits of a 2002 proposal on voluntary certification of bond-related records that will allow destruction of certain records prior to the general requirements of the IRC and regulations. This project should include the assistance of stakeholder groups in developing an appropriate certification program.

- **Recommendation:** The Service should consider establishing a Recordkeeping Agreement Pilot Program similar to the one established by Notice 2004-11 related to the Credit for Increasing Research Activities. A similar program could be established for use with complex areas of bond compliance, such as those associated with the private use rule of IRC Section 141.

## METHODOLOGY

The team approached this project through a series of information gathering methods and direct interviews with affected entities comprising the primary tax-exempt bond community, public sector officials and the IRS. The participants included: TE/GE staff, Office of the TEB Director, TEB Office of Outreach, Planning and Review (OPR), TEB Field Operations, a diverse cross-culture of the state and local government officials, and professional associations. Participants from the tax-exempt bond community at-large included: bond issuers, and industry organizations. The underlying review targeted reducing record retention burdens while insuring cost effective tax administration.

The team's first step was to review pertinent Treasury regulations and IRC sections such as IRC Section 6001. The project team also reviewed record retention requirements and practices associated with the Exempt Organizations and Employee Plans divisions of the IRS. This review focused on the nature and retention periods of records associated with these long established divisions of the IRS.

Based upon these and other informational responses, the team sought the tax-exempt bond community's perspective regarding viable alternatives and related issues affecting tax-exempt bond document retention. The following stakeholder groups were contacted: Representatives of the Government Officers Finance Authority (GFOA), the National Association of Bond Lawyers (NABL), the Public Finance Network (PFN) and the National Association of State Treasurers (NAST).

Based upon the above, the team in conjunction with IRS TEB staff reviewed record retention requirements and best practices used for other IRS stakeholders. From this review, several opportunities emerged to apply these practices to the tax-exempt bond environment.

# DISCUSSION

The tax-exempt bond community and the ACT believe that the current record retention environment is unwieldy and counterproductive to both stakeholder and IRS needs. The general record retention requirements under IRC 6001 and related regulations are best suited for tax administration that spans a relatively short time period, such as those associated with personal income tax returns. When applying these general standards to tax-exempt bond issues, significant recordkeeping burdens are created for a bond issue that spans decades. The current environment does not lend itself to voluntary compliance nor accurately reflects the IRS audit and compliance based oversight needs. The following highlights current law, burden and guidance that directly shape today's existing record retention concerns.

## **IRC Section 6001 and Treasury Regulations Section 1.6001-1:**

The basis for the record retention requirements affecting tax-exempt bonds are the general record retention requirements imposed on all taxpayers.

IRC Section 6001, entitled *Notice of regulations requiring records, statements, and special returns*, states: "Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe."<sup>2</sup>

Treasury Regulations further clarify the matter by stating: "The books and records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law."<sup>3</sup>

## **Record Retention Burden:**

The provisions of the IRC and Regulations stated above produce long-term record retention requirements for most issuers of tax-exempt bonds due to the long-term nature of the capital projects being financed with bond proceeds. Issuers of tax-exempt bonds structure and sell bond issues which correlate to the length of the property financed with proceeds of the issue. For example, if tax-exempt bonds are sold to finance construction of a hospital with an estimated useful life of more than 30 years, the corresponding debt would be sold with principal and interest payments to bondholders that may reflect a 30-year period. In this manner, payment of the debt to finance the project is paid for by users of the facility during its economic life.

Since bond issues may remain outstanding for several decades, the examination period for a tax-exempt bond also spans 2-3 decades. Accordingly, the requirement to maintain books and records and make them available as long as they may be material to the administration of IRC provisions related to tax-exempt bonds creates a unique burden to issuers. This retention

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<sup>2</sup> IRC Section 6001

<sup>3</sup> Treasury Regulations Section 1.6001-1(e)

period is typically longer than the record retention practices of most state and local governments and can create confusion for state and local government entities. Some issuers may be failing to establish special record retention rules for the records attributable to tax-exempt bonds and are instead relying on state statutes, resulting in issuers failing to maintain records for the time period required by the IRS

In addition, a single tax-exempt bond issue may finance dozens of capital projects related to providing essential services by a state or local government. For example, a city may issue a general obligation bond to finance projects related to police and fire departments, parks and recreation, street improvements, and schools. The number of records relating to the investment of proceeds and the use of bond proceeds, such as invoices to contractors and vendors for numerous large capital projects, can number in the thousands for a single bond issue. When multiplied by the fact that many issuers, such as local governments, issue one or more bond issues annually to finance essential capital projects in their community, the cumulative amount of records which must be retained can become overwhelming. Even if an issuer uses available and permitted electronic imaging of documents, maintaining all of the records necessary for an IRS agent to examine a tax-exempt bond issue, the current confusion about what original records need to be maintained could quickly result in the need to establish a warehouse facility to house the information for decades.

### **Existing Guidance for Record Retention Timing:**

Very little guidance exists that instructs bond issuers on which records must be kept and the period of time they must be retained. The primary guidance is the previously stated requirement of IRC Section 6001 and Regulation Section 1.6001-1. In addition, the following rules exist in various Treasury regulations and Service announcements:

**1992 Treasury Regulations:** 1992 Treasury Regulations Section 1.148-8(h)(2) requires that issuers of tax-exempt bonds retain in their books and records any elections made with respect to application of the 1992 regulations on the calculation methodologies for arbitrage rebate calculations for a period of six (6) years after the computation date.

**Treasury Regulation Amendment in 1994:** Effective March 1, 1999, a safe harbor provision was added to Treasury Regulations Section 1.148-5 related to the investment by a tax-exempt bond issuer in certain investment vehicles. Under the provisions of the safe harbor in Treasury Regulations Section 1.148-5, in order to demonstrate that investments in yield restricted escrows or guaranteed investment contracts are at a fair market value, issuers must maintain certain investment documentation (including trade confirmations) until three years after the final maturity of the bond issue.<sup>4</sup>

**FAQs regarding Record Retention Requirements:** In 2003, the IRS posted a frequently asked questions discussion on the IRS web site. In response to the question on how long records must be kept, the Service stated: "To support these tax provisions, material records should *generally* be kept for as long as the bonds are outstanding, plus three years after the final redemption date of the bonds."

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<sup>4</sup> Treasury Regulations Section 1.148-5(d)(6)(iii)(E).

**2004 Technical Advice Memorandum on Refund Requests:** A Technical Advice Memorandum (TAM) issued in 2004 limits the period of time an issuer of tax-exempt bonds may request a refund for the overpayment of arbitrage rebate. This TAM states that the period of time in filing a refund request may no be longer than a period of six (6) years after the final redemption of outstanding bonds of the issue.

Bond document provisions in transcripts supporting the issuance of tax-exempt bonds differ in the length of time outlined for retaining documents associated with a specific bond issue. While some bond attorneys state that all records should be maintained for the life of the bond issue plus 3 years, others suggest maintenance of records until 6 years after the final redemption of the bonds.

A formal audit program for tax-exempt bonds was not initiated until 1993. As a result, there is minimal audit experience or basis for issuers to determine what the IRS has determined to be sufficient evidence for the examination process. Some types of bond issues, such as student loan bonds, have experienced a limited number of IRS examinations and, accordingly, the Service has not developed a guideline for identifying the types of records required to adequately conduct an examination of that type of bond issue. In large part, the absence of TEB resources and higher compliance priorities has created this inadvertent “informational gap”. Without clear and reasonable standards, both IRS audit efficiency and the tax-exempt bond community’s compliance will be adversely impacted since neither the IRS nor tax-exempt bond customers can effectively perform in an undefined audit environment.

IRC Sections 141-149 provide rules related to the issuance of various types of bond issues including governmental bonds, private activity bonds, single-family and multi-family housing bonds, and student loan bonds. Each of these bond issues possesses unique record retention requirements. This diversity presents a myriad of technical and record retention issues. Likewise, a presumption that “one size fits all” related to record retention appears flawed. Ultimately, the IRS must commit resources to fully explore its audit needs and begin crafting regulations which meet this need as well as reducing the record retention cost and burden. Regulations which ignore legitimate record retention problems will only continue to aggravate long-standing inefficient and costly compliance practices by issuers. On the other hand, regulations which embrace valid record retention standards will strengthen voluntary compliance and reduce overall IRS based audit costs.

# RECOMMENDATIONS

The following recommendations address to the essential needs of both the IRS and tax-exempt bond issuers.

1. **Development of a Revenue Procedure for Tax-Exempt Bonds Record Retention.** The ACT recommends that Treasury and the Service develop a revenue procedure, or other formal guidance, to identify what constitutes “material records” for tax exempt bonds. Since 1993, the IRS has had direct examination experience with numerous bond issues, and we believe a basis exists for developing guidance as to the types of records necessary to support an examination of bonds.

The guidance should allow for the use of general ledger, or similar, detail in lieu of most invoices supporting expenditure of bond proceeds. The relative audit value of maintaining each and every invoice serves no meaningful function. IRS concurs that alternatives such as applying general ledger detail in lieu of all invoices represent viable, albeit limited, solutions to reduce record keeping burdens.

The Service needs to formally adopt a maximum period for which records must be retained for tax-exempt bond issues. The Revenue Procedure should establish whether the records retention period is either three years or six years after the final redemption of the bonds.

The rules established in the guidance should be concise and straightforward to administer or issuers will not see a benefit to adopting any safe harbors which are established. Given the complex environment of tax-exempt financings, the creation of record retention guidelines should be viewed as a multi-phased endeavor. The first phase should focus on high general parameters which address the least controversial areas but can be readily applied and implemented. This approach not only yields mutually beneficial results to IRS and the tax exempt bond community, but also lays a foundation of cooperation when addressing the subsequent and more difficult record retention issues.

Issuers and conduit borrowers of bond issues need further guidance on the nature of records to be retained and whether the issuer, conduit borrower, or a third party should maintain those records. For example, the issuer of a conduit bond should be required to maintain the bond transcripts and underlying documents while the conduit borrower (or a designated third party) should be required to maintain the investment and expenditure records on the use of the bond proceeds.

The Revenue Procedure should describe specific records that are unique to a particular type of bond issue, such as a bond anticipation note, a single-family housing issue, or an issue involving a public/private partnership to develop a project.

2. **Establishment of an Exception for Arbitrage Rebate Record Retention.** We recommend the Service should develop an exception for issuers of governmental and IRC



Section 501(c)(3) bonds related to the record retention requirements associated with arbitrage rebate compliance.

Issuers and conduit borrowers of tax-exempt bonds are required to rebate all arbitrage profits earned from investing gross proceeds associated with the sale of the bonds. Since most investment income is generated during the construction phase of a project when there are unspent bond proceeds, once the project is completed and all the proceeds are expended there is no opportunity for arbitrage profits (except where a cash reserve fund is maintained). In addition the tax code requires arbitrage rebate reports to be filed after five years (when arbitrage is present) detailing the use of bond proceeds and any investment income generated during that time period. These reports, frequently prepared by independent private firms, document compliance with the IRC regarding arbitrage profits and the amount if any of payment to the IRS.

In the case where all of the proceeds of a bond issue have been expended and there is no potential for future investment income subject to rebate, we believe the arbitrage rebate calculation report detailing the allocation of proceeds to expenditures could replace the original underlying documentation (such as invoices) and eliminate the need for underlying documents to be maintained for the life of the bond issue plus three years. The goal of such an exception would be to eliminate, to the extent possible, most records other than the bond transcripts for the issue. The exception should allow for records to be maintained no more than three years after a required arbitrage rebate filing date.

**Expenditure Records.** Most of the underlying expenditure records, such as invoices supporting payments to contracts, could be summarized in general ledgers or other internal reports. It is our understanding that, in some instances, agents rely on general ledger support when performing an examination of a bond issue. If general ledger information meets much if not all of certain agent audit needs, perhaps a general rule can be adopted that formalizes and acknowledges this business practice. Bright line tests such as a threshold of invoice amounts would define that guidance. For example, instead of requiring that all invoices be retained, establish rules only invoices only over a designated amount (e.g., \$1 million) must be retained. Alternatively, the Service might consider requiring that invoices greater than a specified percentage of the bond proceeds be retained.

The Service could require that only invoices supporting the expenditure of a certain dollar amount or a specified percentage on the bond issue must be maintain as long as summary information (general ledger detail) exists for all expenditures related to the bond issue. For example, the Service might consider a requirement that only invoices representing expenditure to a single contractor that exceeds  $\frac{1}{4}$  of one percent of the net proceeds of the issue must be retained for the life of the bonds.

**Investment Records.** We believe that most of the underlying investment records, such as trade confirmations or voluminous bank and trustee statements can be summarized in either internal accounting reports or cash flows included in the formal computations of the arbitrage rebate amount. Members of the IRS have expressed concern that allowing destruction of certain investment records would make it difficult to examine the fair market value requirements for establishment of yield restricted escrows and guaranteed

investment contracts. However, the safe harbor rules of the arbitrage regulations require issuers to maintain copies of bid forms and trade confirmations to demonstrate compliance with those rules.<sup>5</sup> We would emphasize that the requirement to maintain trade confirmations for the investment of bond proceeds should be limited to yield restricted escrows rather than investments purchased for project, debt service, or other unrestricted funds.

- 3. Establishment of Voluntary Certification Program for Record Retention.** The Director of TEB held discussions with members of the tax exempt bond community in 2002 to explore the possibility of establishing a voluntary certification program for tax-exempt bond records.

For example, records supporting most of the investment of gross proceeds of an issue could be destroyed after a formal arbitrage rebate calculation has been prepared by the issuer or its agent. By preparing the calculation, required at least once every five years, the issuer is making formal allocation on the expenditure of its bond proceeds. The calculations require the tracing of the investment and expenditure of the proceeds and the outcome of the calculation are underlying schedules detailing the investments and expenditures. An issuer should not be required to maintain all of the underlying investment and expenditure support once a formal allocation has been made and documented in summary format.

We believe the proposal in 2002 has merit and should be further examined as a solution for issuers of tax exempt bonds. We believe that a joint IRS and stakeholder task force be established to further explore the 2002 proposal in depth and recommend new business approaches. This task force should seek to release its findings by December 2006.

- 4. Establishment of Record Retention Agreement Program.** We recommend the Service consider evaluating the merits of establishing a Recordkeeping Agreement Pilot Program similar to the one established by Notice 2004-11 for related to the Credit for Increasing Research Activities. The purpose of the program, available to Large and Mid-Size Businesses, is to resolve issues concerning the type and amount of documents that a taxpayer must maintain, retain, and produce to satisfy the recordkeeping requirements of Section 6001 and to reduce the costs, burdens, and delays frequently encountered by taxpayers and the Service in examinations.<sup>6</sup> The Service and the taxpayer enter into a letter of understanding as to which records must be maintained.

For TEB, this program could be established for use with complex areas of bond compliance, such as those associated with the private use rules of IRC Section 141. TEB, again strapped with minimal resources, has been unable to utilize tools afforded other IRS communities. To advance mutually beneficial goals, IRS should apply these techniques to the tax exempt bond community while assessing and identifying its bottom line audit based informational needs. These applications would not jeopardize the existing audit

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<sup>5</sup> Treasury Regulations Section 1.148-5(d)(6)(iii)(E)

<sup>6</sup> Internal Revenue Bulletin: 2004-6, Notice 2004-11.

environment however; they could advance improvements and identification of system solutions more timely.

The ACT believes the recommendations provided above would relieve excessive and burdensome record retention requirements for tax-exempt bond issuers and improve voluntary compliance.



**Advisory Committee on  
Tax Exempt and Government Entities  
(ACT)**

***Establishing the Enrolled Retirement Plan Agent  
Under Circular 230***

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**June 8, 2005**



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## I.

### **EXECUTIVE SUMMARY**

#### **The Problem**

Over the past several decades there has been a marked shift in how qualified retirement plans are serviced. This has resulted in the creation of a significant group of retirement plan practitioners (including third party administrators and benefit consultants) who are not currently authorized to practice before the IRS but who play a critical role in tax compliance. Employers often rely on this group to maintain the tax qualified status of their plans.

Historically, this group of practitioners was permitted to represent qualified retirement plan sponsors before the IRS with respect to retirement plan matters. The Restructuring and Reform Act of 1998 imposed substantial penalties on IRS employees for unauthorized dealings with third parties. As a result, the IRS revised Form 2848 (Power of Attorney and Declaration of Representative) to prohibit its use by individuals not otherwise authorized to practice before the IRS.

#### **The ACT's Objective**

This project was undertaken to determine whether procedures should be developed to permit those practitioners not currently authorized to practice before the IRS to become enrolled for the limited purpose of addressing certain qualified retirement plan matters (including the filing of applications for determination letters, filing for extensions of Form 5500, responding to employee plan audits, and negotiating with the IRS on behalf of clients with respect to voluntary compliance matters). In this context, we looked at whether the IRS should rely on existing credentialing programs and the possible scope of practice.

#### **Guiding Principles**

In addressing this objective, the ACT looked to Commissioner Everson's stated goal of enhancing enforcement of our tax laws. Two of the Commissioner's objectives are described in the current IRS Strategic Plan as follows:

- Ensure that attorneys, accountants and other tax professionals adhere to professional standards and follow the law.

- Detect and deter abuse within tax-exempt and governmental entities and misuse of such entities by third parties for tax avoidance or other unintended purposes.

### **Recommendations**

The ACT recommends the creation of a new category of limited scope practitioner, known as an "Enrolled Retirement Plan Agent" or "ERPA." The ERPA program would be established under Circular 230 and would be administered by the Office of Professional Responsibility ("OPR"). Given the similarities in structure between the enrolled agents program currently in existence and the recommended ERPA program, we recommend that the examination, enrollment, and renewal procedures of the enrolled agent and ERPA programs mirror each other to the extent possible.

We recommend that the scope of an ERPA's practice before the IRS be limited to certain delineated sections of the Internal Revenue Code relating to retirement plan matters. As a result, the scope of the ERPA examination should be similarly limited. The administration of this examination also should follow the approach presently being developed by OPR for the enrolled agent examination, which will result in OPR outsourcing the examination to an appropriate vendor. Additionally, OPR should utilize the technical assistance of the Employee Plans Division of TE/GE in its development of the objectives, standards, and examination content.

Our recommendation also includes renewal and continuing education requirements that parallel current requirements for enrolled agents. While these continuing education requirements are rigorous, they also are consistent with requirements for other professional groups that are permitted to practice before the Internal Revenue Service, and should enhance compliance.

The ACT believes that over the first five years approximately 3,000 to 6,000 practitioners could avail themselves of this enrollment opportunity. Accordingly, the ACT believes that this program can be implemented by the Internal Revenue Service expeditiously and without unreasonable cost or use of its resources.

The ACT believes its recommendation will establish a mechanism for increasing the accountability of a valuable group of individuals who are an integral part of the maintenance and administration of tax exempt plans.

## II.

### INTRODUCTION

#### A. Reasons for Report

Over the past several decades there has been a marked shift in how retirement plans are serviced. An increasing number of plans are drafted and administered by third-party administrators ("TPAs"), benefit consultants and others who are not or do not employ staff attorneys, certified public accountants ("CPAs"), enrolled actuaries ("Enrolled Actuaries"), or enrolled agents ("Enrolled Agents"); that is, persons authorized to practice before the IRS. These practitioners currently not authorized to practice before the IRS also play a critical role in tax compliance, because employers rely upon them to maintain the tax qualified status of their plans. As a result, they have become the primary point of contact between plan sponsors and the IRS – preparing tax forms, responding to IRS audits, implementing changes to plans in compliance with changing tax laws, and other plan-related activities. Since this group of practitioners is not authorized to practice before the IRS, it also is not regulated by Circular 230, which among other things defines or limits the scope of practice and establishes ethical standards and competency review processes. (See discussion in Section III.C. below.)

This project was undertaken to determine whether procedures could be developed to permit practitioners who are not currently authorized to practice before the IRS to become enrolled for the limited purpose of addressing certain qualified retirement plan matters. These matters would include the filing of applications for determination letters, filing for extensions of Form 5500, responding to qualified retirement plan audits, and negotiating with the IRS on behalf of clients with respect to voluntary compliance matters.

While the vast majority of retirement plan practitioners adhere to ethical practices and to the law, the IRS has little recourse against those practitioners who breach acceptable standards of conduct. The ACT undertook to determine what standards of competence and conduct should apply to those practitioners and how to apply these

standards. While enrollment of retirement plan practitioners offers the privilege and opportunity to fully represent clients with respect to qualified retirement plan matters, those practitioners should be subject to meaningful standards of conduct and a system of sanctions for those who may breach those standards.

**B. The ACT's Objectives**

In approaching this project, the ACT established as its objectives the improvement of professional responsibility among qualified retirement plan practitioners, enhancing the enforcement of the rules, regulations and laws affecting qualified retirement plans, and providing a fair and appropriate procedure for enrolling qualified retirement plan practitioners. To this end, the ACT was guided by these principles:

- The recommendations should be consistent with the Commissioner's goals as outlined in the IRS's Strategic Plan.
- The regulation of practice under Circular 230 should be consistent with the manner in which qualified retirement plans are managed and the manner in which plan sponsors choose to interact with the IRS.
- The privilege and authority to practice before the IRS should carry obligations and regulatory oversight.
- The privileges and authority of groups currently authorized to practice before the IRS under Circular 230 should not be diminished.
- Examination and qualification procedures should be consistent with the scope of enrollment.
- Procedures should be workable using current processes within the IRS.
- Changes should be able to be implemented over a relatively short period of time.
- Changes should be respectful of existing IRS resources.

**C. Summary of Recommendations**

This report recommends that the group of individuals eligible to practice before the IRS be expanded to include practitioners who provide technical services to qualified retirement plans and plan sponsors. Provided these persons are subject to appropriate standards of competency and conduct and in order to strengthen compliance within this segment of the taxpayer community, the ACT believes they should be authorized to

practice before the IRS. The report's recommendations would both make them subject to the standards and responsibilities of Circular 230, and permit them to interact directly with the IRS on matters within the scope of their practice. Creation of a limited category of enrolled agent for qualified retirement plan practitioners will encourage individuals who are already involved in tax compliance, but who are not currently enrolled, to subject themselves to the jurisdiction of the IRS. Once practitioners are enrolled, the IRS will be in a better position to communicate with them regarding tax compliance, to monitor their performance, and to sanction any misconduct. In this report we refer to this group as Enrolled Retirement Plan Agents ("ERPAs").

The ACT believes that the qualified retirement plan community will readily embrace the ERPA designation and enrollment process. Clearly the qualified retirement plan community has exhibited a need for its practitioners to participate in the determination letter, audit, and voluntary compliance functions. Additionally, it would appear that the new ERPA "credential" will help validate a practitioner's competence. The ACT also believes that the professional organizations which provide these practitioners with educational opportunities and organized representation will endorse this recommendation because its objectives are consistent with the objectives of those organizations.<sup>1</sup>

#### **D. Meeting IRS Strategic Plan Objectives**

IRS Commissioner Mark Everson established the enhancement of the enforcement of our tax laws as a principal goal of his administration.<sup>2</sup> On July 14, 2004, the IRS published its Strategic Plan 2005-2009, and prominently incorporated the Commissioner's goal of enhanced enforcement of the tax laws. The Plan establishes this and other goals, outlines objectives to meet its goals, and then describes the methods and strategies the IRS will use to accomplish its objectives. The ACT believes

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<sup>1</sup> The American Society of Pension Professionals & Actuaries ("ASPPA") reports its mission as "to enhance the competencies of retirement plan professionals and improve the retirement plan system," and the National Institute of Pension Administrators ("NIPA") reports its mission as to "to enhance professionalism in the retirement plan industry." Both professional organizations are leading representatives of qualified retirement plan practitioners.

<sup>2</sup> During the installation ceremony of Commissioner Mark Everson on June 11, 2003, he stated, "The IRS will enforce the law across all sectors, but with particular vigor in the corporate arena and for high-income individuals who enter into abusive shelters to game the system."

that amending Circular 230 to permit ERPAs to practice before the IRS furthers at least two of the four stated objectives for enhancing enforcement. These two objectives<sup>3</sup> are described in the Strategic Plan as follows:

- Ensure that attorneys, accountants and other tax professionals adhere to professional standards and follow the law.
- Detect and deter abuse within tax-exempt and governmental entities and misuse of such entities by third parties for tax avoidance or other unintended purposes.

**1. Ensuring that Tax Practitioners Adhere to Professional Standards and Follow the Law**

The ACT believes its recommendation to recognize the ERPA under Circular 230 is consistent with the methods and strategies enumerated within the Strategic Plan for accomplishing the objective of ensuring that tax practitioners adhere to professional standards and follow the law. These methods and strategies include the following:

- Strengthen partnerships with practitioners to achieve the highest level of professional integrity and improve tax compliance.
- Establish and communicate clear, robust, current and meaningful standards of conduct for tax practitioners.
- Establish and maintain a vigorous, targeted and effective system of practitioner oversight.
- Establish and administer a fair, diligent and effective system of sanctions for practitioners who fail to observe standards of conduct.

**2. Deter Abuse Within Tax Exempt Entities**

Commissioner Everson and the Strategic Plan have elevated the curtailment of abuse within tax exempt entities to the highest of priorities. The ACT believes its recommendation is consistent with this objective, by establishing a mechanism for increasing the accountability of a target group of individuals whose business includes the maintenance and administration of a tax exempt entity. For example, at least two

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<sup>3</sup> In meeting the goal of enhancing the enforcement of the tax law, the IRS Strategic Plan for 2005 through 2009 also established as objectives: (i) discourage and deter non-compliance with emphasis on corrosive activities by corporations, high-income individual taxpayers and other contributors to the tax gap and (ii) detect and deter domestic and off-shore based tax and financial criminal activity.

qualified retirement plan arrangements recently have been cited by the IRS as abusive.<sup>4</sup> While practitioners who promote these vehicles are subject to a regimen of disclosure,<sup>5</sup> which may lead to significant monetary penalties for violations (and even criminal prosecution for the most egregious conduct), the ability to sanction under Circular 230 enhances the Commissioner's arsenal for combating misuse of these tax exempt entities.

#### **E. Data Gathering Process**

In developing its recommendations, ACT members interviewed staff members of the Employee Plans Division of TE/GE and the Office of Professional Responsibility ("OPR") of the IRS. Additionally, one member of the ACT made an on-site visit to an OPR office which administers much of the enrollment process for Enrolled Agents. ACT members also met with representatives of several professional organizations of employee benefits consultants and TPAs to gain an understanding of the educational and certification programs currently existing within the industry. Finally, in an attempt to determine the number of plans that are represented by practitioners not enrolled to practice before the IRS, ACT members met with representatives of the document preparation industry.

During the course of this project, the ACT sought comments from interested parties via the EP Newsletter. A description of the issue and requests for comments were contained in both the Fall 2004 edition and the Winter 2005 edition of the EP Newsletter. The ACT received a substantial number of comments from practitioners, and many of these comments included the following observations:

- While it was noted that the qualified retirement plan industry is relatively new, having experienced most of its growth and development since the passage of ERISA, there is nevertheless extensive experience and

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<sup>4</sup> The IRS currently reports abusive transactions involving insurance policies in Section 412(i) plans (see News Release IR-2004-21) and S Corporation ESOPs (see Rev. Rul. 2004-04) as listed transactions.

<sup>5</sup> The IRS website and its guidance report "listed transactions." Listed transactions require disclosure by participating parties and material advisors. The failure to properly disclose a listed transaction will subject the participating party and the material advisor to significant penalties. See IRC Section 6707A as added by Section 811(a) of the American Jobs Creation Act of 2004, which imposes substantial penalties for the failure to disclose reportable transactions including listed transactions. Also see IRC Section 6111, as amended by Section 815(a) of the American Jobs Creation Act of 2004, which requires material advisors to report in the form of a return prescribed by the IRS, information concerning a reported transaction including listed transactions.

expertise among practitioners in the industry. A number of practitioners who submitted comments have worked as TPAs for 20 or more years.

- The industry itself promotes professionalism through various organizations which offer certifications and continuing professional education for their members. Various professional designations were frequently cited as good indicators of professional competence. Attached to this report as Appendix B is a detailed description of the majority of the designations and Appendix C contains a summary of information regarding the principal professional designations.
- Practitioners serving as TPAs are often in the best position to represent an employer with respect to qualified retirement plan matters, because of their access to data and their intimate understanding of a plan's operation. If the IRS is forced to deal directly with employers who are not knowledgeable about the details of qualified retirement plan matters, the time spent by the IRS in resolving individual cases will likely increase. Creation of a special category of enrolled agent for qualified retirement plan matters will help the IRS more efficiently administer qualified retirement plan law.
- Many attorneys, CPAs, and Enrolled Agents who are enrolled under Circular 230 are not familiar with the specific compliance issues affecting qualified retirement plans. The large size and specialized nature of the qualified retirement plan industry, speaks to the need for the creation of an enrolled qualified retirement plan agent.

Many of the comments included specific recommendations for expanding enrollment within the qualified retirement plan community, including the following:

- Creation of a specific examination to allow practitioners to become enrolled for the limited purpose of representing qualified retirement plans.
- Conditioning enrollment for the limited purpose of representing qualified retirement plans upon acquiring certain certifications or designations offered by professional organizations.



- Allowing practitioners to become enrolled for the limited purpose of representing qualified retirement plans based upon completion of a specified number of years of experience in the industry (“grandfathering”).

Interestingly, there were comments both in favor and in opposition to each of these recommendations. For example, while some comments recommended a professional certification as a condition of enrollment, other comments expressly opposed the use of existing professional certifications and advocated an enrollment examination.

Nevertheless, the comments received were helpful in identifying issues and providing guidance for the ACT.

### **III.**

#### **LEGAL BACKGROUND**

##### **A. History Prior to 1998**

Third party administrators ("TPAs") have been an integral component of the country's qualified retirement plan system for decades.

In order to systematize and improve the quality of administration, many TPAs have even developed and marketed their own plan documents. Employers frequently rely upon these TPAs for all aspects of plan administration, including compliance with federal law. Their clients are generally smaller employers who lack in-house resources to deal with the IRS directly. Accordingly, many TPAs historically have had a significant role in representing clients before the IRS with respect to qualified retirement plan matters, including assisting employers in obtaining determination letters, participating in IRS audits of plans, and processing Employee Plans Compliance Resolution System ("EPCRS") submissions, etc.

Many small TPA firms lack staff authorized to practice before the IRS. Prior to 1998, retirement plan practitioners not otherwise authorized to practice before the IRS typically used Form 2848 to demonstrate client authorization for the IRS to speak with the practitioner. The IRS generally accepted these authorizations. Although Form 2848 always included a declaration (Part II) that the representative was authorized to practice before the IRS, the official instructions stated that the form could be used to "grant authority to an individual to represent you before the IRS and to receive tax information." In some cases, the form was apparently treated as authorization to

receive/provide tax information and in some cases the practitioner was apparently permitted to represent the taxpayer notwithstanding the lack of eligibility under one of the stated categories in Part II of Form 2848.

**B. History Following 1998 Legislative Changes**

Currently, Form 2848 is no longer accepted if the taxpayer's representative is not authorized to practice before the IRS, i.e., is not an attorney, a CPA, an Enrolled Actuary or an Enrolled Agent. This change was implemented administratively in 2004, in response to the Restructuring and Reform Act of 1998, which imposes significant penalties on IRS employees for unauthorized dealings with third parties. Form 2848 was modified to ensure that only authorized persons (attorneys, CPAs, Enrolled Actuaries, or Enrolled Agents) are given power of attorney by a taxpayer by the use of Form 2848. The official instructions for Form 2848 now state that: "If the representative you appoint is not qualified to sign Part II of this form, Form 2848 will not be honored and will be returned to you. As of March 2004, the IRS will no longer treat such invalid forms as authority for the person you named to receive your tax information."

This change effectively prohibits TPAs and other retirement plan practitioners who previously had directly represented taxpayers before the IRS with respect to qualified retirement plan benefit matters from continuing that representation. The change in position with regard to Form 2848 has been described by some as the "disenfranchisement" of a group of competent qualified retirement plan practitioners – a change which is extremely discomfoting to the practitioners and their clients alike.

Today, practitioners who are not in one of the four authorized groups in Circular 230, and are therefore "unenrolled preparers," can only undertake certain actions on a third party's behalf as an unenrolled return preparer. These actions include: practitioners representing themselves or immediate family members; employees, partners and officers representing a specified entity; and individuals who prepare and, if required, sign a taxpayer's tax return ("Unenrolled Preparers"). Forms 5500 are information returns and not tax returns. Consequently, persons who solely prepare Form 5500 might not be "unenrolled preparers" within the meaning of the statute, and if they are not they would not be subject to regulation under Circular 230. Unenrolled

Preparers are regulated by the Small Business/Self Employed (SB/SE) Compliance Division of IRS.

The ACT understands that determination letter applications and EPCRS submissions submitted by an unenrolled practitioner prior to April 1, 2004 are being processed according to prior practice. For all new determination letter applications and EPCRS submissions, practitioners who are not admitted to practice may communicate with the IRS when authorized by their clients by Form 8821 (Tax Information Authorization), but they may not negotiate and settle with the IRS. (See Section VI, Transitional Issues, for a further discussion of the authority granted by Form 8821.)

**C. How Circular 230 Works**

Section 330 of Title 31 of the United States Code authorizes the Secretary of the Treasury to regulate the practice of representatives before the Treasury Department and, after notice and an opportunity for a proceeding, to suspend or disbar from practice those representatives who are incompetent, disreputable, or who violate regulations prescribed under Section 330. The OPR is the IRS' "arm" that interprets and applies Title 31, Code of Federal Regulations Subtitle A, Part 10, "Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries and Appraisers before the IRS." These regulations are generally known as "Treasury Department Circular 230," or simply "Circular 230."

Circular 230 describes expectations, rights and obligations of those who represent taxpayers before the IRS. Circular 230 essentially prescribes the standards of conduct and ethics for practitioners – detailing both the privileges and the accountability. In addition, Circular 230 prescribes the qualification requirements for various groups to be eligible to practice before the IRS. While the qualification requirements for attorneys and CPAs are based on the licensing requirements of the states in which they practice, Circular 230 requires Enrolled Agents to pass an IRS-prepared and administered examination. Others may qualify as Enrolled Agents through work experience with the IRS ("IRS EAs"). Actuaries may qualify as Enrolled Actuaries by meeting the qualification requirements prescribed by the Joint Board of Enrolled Actuaries ("Joint Board") Persons who prepare tax returns are subject to regulation under Circular 230 as "Unenrolled Preparers."

Among current responsibilities of the OPR and its approximately 55 employees are the development, administration, and grading of the Enrolled Agents examination. This examination is administered to approximately 11,000 individuals each year. In addition, OPR is responsible for the tri-annual renewal of the enrollment of approximately 41,000 existing Enrolled Agents, for monitoring compliance with continuing education requirements for Enrolled Agents and for monitoring the conduct of all enrolled practitioners.

**1. Those Authorized to Practice Before the IRS (§§10.3 & 10.7)**

As previously noted, there are four main categories of practitioners authorized to practice before the IRS. Except as otherwise limited by Circular 230, "practice before the IRS" includes all matters connected with presentations relating to a taxpayer's rights, privileges or liabilities under laws or regulations administered by the IRS. These matters include, but are not limited to: (i) preparing and filing documents, (ii) corresponding and communicating with the IRS, and (iii) representing a taxpayer at conferences, hearings and meetings. The four authorized categories are:

- Attorneys
- Certified Public Accountants ("CPAs")
- Enrolled Actuaries
- Enrolled Agents

There are two types of Enrolled Agents - those who pass a Special Enrollment Examination ("SEE") and those who are IRS Enrolled Agents.

**2. The Enrolled Agents Enrollment Process (§§ 10.3-10.6)**

The qualification process for Enrolled Agents to practice before the IRS is made up of three separate administrative steps: examination, enrollment, and renewal. Each step entails the submission of an application form to the OPR, which is reviewed to determine compliance with the administrative requirements of Circular 230.

**a. Examination**

Section 10.4 of Circular 230 provides that the Director of the OPR "may grant enrollment to applicants who demonstrate special competence in tax matters by written examination administered by, or administered under the oversight of the Director." Presently this requirement is met by the OPR's development, administration, and

grading of the SEE. Generally, the SEE tests the applicant's technical competence in federal tax law, although it also covers ethical issues and procedural matters concerning practice before the IRS. The SEE is made up of four separate parts, and an applicant must earn a passing score on each part to be eligible for enrollment. If less than all of the parts are passed at one time, parts may be carried over to future examinations, if minimum retention scores are achieved. The four parts of the SEE cover the following:

- individual income tax (Part I)
- sole proprietorships and partnerships (Part II)
- corporations, fiduciaries, estate and gift tax, and trusts (Part III)
- ethics, record keeping procedures, appeal procedures, exempt organizations, retirement plans, practitioner penalty provisions, research materials, and collection procedures (Part IV).

Information concerning the examination is readily available on the IRS' web site, including prior examinations and answers.

**b. Enrollment**

Attorneys and CPAs have no specific enrollment process; they simply must demonstrate they are licensed to practice their profession and are authorized to represent the taxpayer (Form 2848). The enrollment and the renewal of enrollment of Enrolled Actuaries are governed by the regulations of the Joint Board for the Enrollment of Actuaries at 20 CFR 901.1 through 901.71.

An Enrolled Agent applicant must demonstrate both technical proficiency and ethical behavior. For those who wish to become Enrolled Agents, technical proficiency is demonstrated either by passing the SEE or through their former employment with the IRS. In addition to demonstrating technical proficiency, the applicant may not have "engaged in any conduct that would justify the censure, suspension, or disbarment of any practitioner under Circular 230."<sup>6</sup>

The application for enrollment, Form 23, generally requests background information concerning the applicant. A number of questions address tax, professional, or other legal problems the applicant may have encountered. In processing the application, the OPR reviews tax transcripts to determine if the applicant is compliant.

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<sup>6</sup> Section 10.4(a) of Circular 230

During the review process, names are circulated through the various operating divisions of the IRS to determine if other offices may have information that affects the applicant's qualification. Most enrollment applications are approved without further action. In some cases, the Director of the OPR may request additional information or clarification concerning the applicant. In rare instances, the Director will deny the applicant enrollment status. If rejected, the applicant is provided with an opportunity to appeal the determination.

**c. Renewal and Continuing Education**

Enrolled Agents must renew their enrollment every three years.<sup>7</sup> The principal requirement for renewal is a demonstration of continued competency, either solely through continuing education, or by retaking the SEE and completing a limited number of continuing education credits.

The continuing education requirement is met by the completion of a minimum of 72 hours of qualifying continuing education during each three-year period. A minimum of 16 hours of continuing education credit, including 2 hours of ethics or professional conduct, must be completed during each year. To be eligible for continuing education credit, the course of learning must meet specified criteria for content and be offered by a qualified sponsor. Credit is also given for self study, serving as an instructor or publishing articles or books. The failure to comply with continuing education requirements is grounds for removal from the roster of active Enrolled Agents, thus terminating the practitioner's ability to practice before the IRS. We note that the OPR has begun to structure an audit program to verify reported continuing education credits.

In lieu of the extensive continuing education requirements, an Enrolled Agent may qualify for renewal by passing each part of the SEE administered during the three-year period prior to renewal and completing a minimum of 16 hours of qualifying continuing education during the last year of the individual's three-year enrollment cycle. The IRS website has a special section dedicated to the Enrolled Agent process. It can be accessed at [www.irs.gov](http://www.irs.gov) and searching for "enrolled agents."

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<sup>7</sup> Section 10.6(d) of Circular 230

### **3. Limitations on Practice Before the IRS (§§10.3, 10.4 & 10.7)**

Attorneys and CPAs have no specified limitations on their ability to practice before the IRS. Enrolled Actuaries and certain Enrolled Agents, in contrast, have limitations as specified in Circular 230.

#### **a. Enrolled Actuaries**

Enrolled Actuaries are limited to representing taxpayers with respect to issues involving certain specified Internal Revenue Code sections, including, §§ 401, 403(a), 404, 405, 412, 413, 414, 419, 419A, 420, 4971, 4972, 4976, 4980, 6057-6059, 6652(e)&(f), 6692, 7805(b) and the waiver of funding for nonqualified plans (ERISA §303).

#### **b. Enrolled Agents**

Enrolled Agents other than IRS Enrolled Agents are not limited in their scope of practice before the IRS. IRS Enrolled Agents may be limited to the presentation of matters only within a particular area or only before the particular unit or division of the IRS for which the IRS Enrolled Agents former employment qualifies him or her. However, other IRS Enrolled Agents may have no limits on the scope of their practice before the IRS.

#### **c. Unenrolled Preparers**

Unenrolled Preparers may only represent the taxpayer for whom they prepared a return before revenue agents, customer service representatives or similar officers or employees of the IRS during an examination of such tax return. Generally, this right does not permit the Unenrolled Preparer to represent the taxpayer before appeals officers, revenue officers, IRS counsel or similar officers or employees of the IRS or Treasury. (For more information, see Rev. Proc. 81-38.)

### **4. Outsourcing the Current SEE**

Recently the OPR publicly announced its intention to outsource the SEE to professional testing companies. Although advances have been made in processing the examination, the IRS has recognized that “greater expertise in the area of test

development and delivery resides in private industry.”<sup>8</sup> In discussions with Brien T. Downing, Assistant Director of the OPR, the ACT has learned that:

- The IRS wants a vendor to design and administer a nationwide test that is readily accessible and user friendly.
- The vendor must utilize psychometrics<sup>9</sup> to determine if the examination is meeting the objectives established by the IRS.
- The vendor will be responsible for the September 2006 examination.
- The redesigned SEE will likely have a greater emphasis on ethical and procedural questions rather than purely technical tax questions.
- The cost of developing, administering, and grading the examination must be borne by the successful vendor, which will be reflected in the fees charged for the examination.

#### IV.

#### **WHO IS AFFECTED BY CHANGES?**

The "disenfranchisement problem" described in this report has an impact on both qualified retirement plan practitioners and on the plans to which they provide services. While there is no precise statistical data regarding the number of qualified retirement plan practitioners who are no longer able to represent clients using Form 2848, there is a great deal of information from which one can infer the magnitude of the impact.

The qualified retirement plan community is large. The IRS reports that in 2003, Form 5500s were filed for 787,417 defined contribution plans having less than 100 participants, and an additional 63,817 defined contribution plans having more than 99 participants. The ACT's findings indicate that most small plans are administered externally (i.e., not in house by the employer). Based upon interviews with industry representatives and the review of comments submitted by practitioners, it appears that many of these plans are drafted and administered by TPAs that do not employ a person currently authorized to practice before the IRS. Additionally, it appears that even when

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<sup>8</sup> In an open letter addressed to the tax professional community dated June 24, 2004 and appearing on the IRS web site, the Director of OPR reported the status of the outsourcing project and their commitment to the implementation of new testing procedures not later than the 2006 test year.

<sup>9</sup> Psychometrics is the science of measuring psychological aspects of a person such as knowledge, skills, abilities, or personality. Key concepts include test reliability and test validity. A reliable test measures something consistently while a valid test measures what it is intended to measure.



the TPA does have a authorized representative on its staff, the majority of client services are performed by employees who are not enrolled. The ACT recognizes that in many cases, these employees have primary responsibility for a client's plan and are in the best position to answer questions and otherwise interact with the IRS.

Another way of measuring the impact of disenfranchisement is to consider the number of practitioners in the qualified retirement plan field who already hold professional designations other than "lawyer," "certified public accountant," or "actuary." The American Society of Pension Professionals and Actuaries (ASPPA) reports that over 3,400 of its members hold the professional designations of Qualified 401(k) Administrator, Qualified Pension Administrator, or Certified Pension Consultant. The International Foundation of Employee Benefit Plans (IFEBP) reports that it has granted Certified Employee Benefits Specialist status to nearly 10,500 individuals. Another 1,600 individuals are certified as Retirement Plan Associates. The Institute of Certified Bankers (ICB) had certified approximately 1,100 individuals as Certified Retirement Service Professionals. The International Foundation for Retirement Education (InFRE) reports that it has credentialed over 1,600 individuals as Certified Retirement Counselor's or Certified Retirement Administrators. The National Institute of Pension Administrators (NIPA) has certified over 600 individuals as Accredited Pension Administrators. While some practitioners hold more than one certification or designation, or already fit into one of the categories authorized to practice before the IRS, there are clearly a large number of practitioners in the qualified retirement plan community who are not currently authorized to practice before the IRS. For example, we believe that many of the persons holding ASPA's designation of Certified Pension Consultant may also be qualified under another ASPA designation.

Based upon the information available, the ACT estimates that somewhere between 3,000 to 6,000 individuals would enroll under the ERPA program in its first five years.

V.

**PROPOSAL**

A. **Proposed Category of Enrolled Retirement Plan Agent [Who They Are and What They Can Do]**

The ACT recommends that a new category of practitioners qualified to practice before the IRS be created – the Enrolled Retirement Plan Agent ("ERPA"). This category would have a limited scope enrollment, analogous to Enrolled Actuaries. The ACT reached this recommendation after analyzing the need, competing interests, possible alternatives, plan and plan sponsor realities, and IRS resources.

While cognizant that one possibility is to merely require Enrolled Agent certification for qualified retirement plan practitioners who wish to practice before the IRS, the ACT concluded that this option would not best serve the needs of the qualified retirement plan community. The new ERPA designation and the limited scope of practice attributable to such enrollment would address a significant group of practitioners who otherwise do not appear likely to seek the Enrolled Agent certification because they have no intention or desire to work on an unlimited scope basis. Instead, they will work exclusively in the qualified retirement plan area and need expertise solely in that area. This approach would also meet the needs at the IRS to effectively and efficiently process pending matters with the practitioners who are closest to the facts, most knowledgeable about a plan and who do the preponderance of work on a particular filing. Requiring these practitioners to successfully complete the unlimited scope Enrolled Agent examination would not produce a better result (*i.e.*, better plan administration and compliance with the tax rules) than limiting an ERPA examination to qualified retirement plan issues, and in the ACT's view would actually produce a less favorable result.

The principal alternatives<sup>10</sup> the ACT considered for enrollment of new ERPAs were:

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<sup>10</sup> The ACT briefly considered, but rejected utilizing a portion of the Enrolled Actuaries examination (Part EA-2B) or the Enrolled Agents examination (Part IV) which is designed to test applicants on general topics relating to qualified retirement plans. This decision was based upon the belief that a limited scope examination tailored to the ERPA best serves its objectives. Another alternative that was also considered and rejected was a legislative initiative to establish an agency similar to the Joint Board of Actuaries to oversee this project.

- Utilize existing credentialing programs provided by one or more organizations offering certifications to retirement plan practitioners.
- Utilize a program that mirrors the current system for enrolling Enrolled Agents and provide for the integration of the two enrollment programs to the extent possible.

After careful consideration, the ACT has concluded that sufficient similarities exist between the Enrolled Agent program and the recommended ERPA program that the examination, enrollment, and renewal functions should mirror each other to the extent possible.

**B. Qualification Examination**

**1. Utilizing Existing Credentialing Programs**

Retirement plan practitioners currently are offered a wide range of credentialing opportunities to validate their professional competence. For example, the American Society of Pension Professionals and Actuaries, the National Institute of Pension Administrators, the International Foundation of Employee Benefit Plans, the International Foundation for Retirement Education, Society of Professional Administrators and Recordkeepers, World at Work and the American Bankers Association each offer one or more professional designations. Typically, these designations require the completion of courses of study and the passage of one or more examinations. While the designations generally recognize professional competence in fields related to qualified retirement plans, there appears to be great disparity in the areas they emphasize and the standards for qualification. (See Appendixes B and C)

Clearly, the utilization of one or more existing credentialing programs would provide an expeditious means to enroll large numbers of practitioners without imposing transitional burdens on the OPR. Furthermore, this de facto “outsourcing” of the entire credentialing function in this manner would relieve the IRS of the ongoing cost and burden of testing new practitioners. The ACT recognizes that many of the existing professional designations require practitioners to demonstrate a high level of technical knowledge and complete lengthy periods of practice in the qualified retirement plan area. Nevertheless, for the reasons stated below, the ACT chose not to recommend this enrollment alternative.

## 2. IRS-Managed Examination Process

The ACT recommends an IRS-managed examination process for the following reasons.

- Examinations offered by organizations providing professional credentialing programs generally only test technical knowledge, and do not consider such things as the ethical standards prescribed by Circular 230 and the procedures and other requirements for practice before the IRS.
- Testing standards vary widely among professional organizations, and would require the IRS to evaluate and monitor which organizations and which designations meet their criteria for enrollment.
- To maintain both minimum quality standards and consistency across organizations, the IRS would be required to establish minimum requirements and review multiple programs to ensure those requirements are met.
- Selecting one or more organizations and one or more designations, while rejecting others would put the IRS in the untenable position of being perceived as favoring certain groups.
- There is no systemized approach to ensure or dictate that these groups use the psychometric testing approaches being implemented by the OPR.

The ACT contemplates a limited scope examination for ERPAs. Since an ERPA will only practice within the confines of certain specified sections of the Internal Revenue Code (see Scope of Enrollment Section), the “technical” component of the ERPA examination should also be similarly limited. Generally, this will mean testing practitioners on all types of qualified retirement plans, including: defined contribution plans, defined benefit plans, and ESOPs. (Funding issues for defined benefit plans which require the specialized expertise of an actuary would not be tested.) Ethical, procedural, and practical elements should also be tested and could mirror similar components of the Enrolled Agent examination.

As described above, the OPR presently administers the enrollment of Enrolled Agents to practice before the IRS, and shortly will outsource the development and

administration of the SEE. It will continue, however, to be responsible for establishing objectives and standards for the SEE that the successful vendor must meet.

The ACT recommends that the ERPA examination also be outsourced by OPR. Furthermore, the ACT recommends that the Employee Plans Division of TE/GE provide technical assistance in the development of the objectives, standards and examination content.<sup>11</sup>

The decision to recommend mirroring the Enrolled Agent process is principally based upon the Enrolled Agents' program's long history, integrity, and "in place" infrastructure of administrative and management personnel. In this regard, it is believed that the ERPA program could be implemented expeditiously and with the addition of a small number of new OPR staff members in Detroit and Washington. Furthermore, the timing of its implementation coincides with the OPR's SEE outsourcing initiative, and could facilitate the integration of the two programs at an early date.

#### **C. Renewal and Continuing Education**

The ACT further proposes renewal and continuing education requirements that parallel the current requirements for Enrolled Agents. The current Enrolled Agent continuing education requirements, while rigorous, tend to mirror the continuing education requirements for the other professions that are permitted to practice before the IRS. The ACT believes that ongoing audits of CPE credit for ERPAs are essential to the maintenance of high standards of practice.

#### **D. Scope of Enrollment**

Retirement plan practitioners generally engage in the following activities:

- Preparing and filing requests for initial determination letters on the qualified status of retirement plans
- Preparing and filing requests for determinations on plan termination
- Preparing and filing requests for the extension of filing Form 5500
- Preparing and filing annual reports on Form 5500
- Preparing and filing excise tax returns

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<sup>11</sup> Presently the Employee Plans Division provides technical assistance to the Joint Board of Actuaries in its administration of the Enrolled Actuary Examination.

- Representing qualified retirement plans in audits by the IRS or other governmental agencies
- Preparing and filing or assisting in filing requests under voluntary compliance programs

The ACT recommends that the scope of practice for ERPAs encompass these activities.

In order to perform these activities, the ACT additionally recommends the following

Code Sections be included within the scope of practice for ERPAs:

- Section 72 (relating to taxation of distribution from plans)
- Section 401 (relating to qualification of employee plans)
- Section 402 (relating to taxability of certain trusts)
- Section 403(a) (relating to whether an annuity plan meets the qualification requirements)
- Section 404 (relating to deductibility of employer contributions)
- Section 404(a)(2) (relating to deductibility of employer contributions)
- Section 408 (relating to various individual retirement accounts and programs)
- Section 410 (relating to minimum participation standards)
- Section 411 (relating to minimum vesting standards)
- Section 412 (relating to funding, but only, as to defined contribution plans)
- Section 413 (relating to application of qualification requirements for collectively bargained plans and for plans maintained by more than one employer)
- Section 414 (relating to definitions and special rules with respect to the qualified retirement plan area)
- Section 415 (relating to limitations on contributions and benefits under qualified retirement plans)
- Section 416 (relating to special rules for top-heavy plans)
- Section 417 (relating to survivor annuities)
- Section 512 (relating to unrelated business income)
- Section 513 (relating to unrelated trade or business)
- Section 514 (relating to unrelated debt financed income)

- Section 4972 (relating to tax on nondeductible contributions to qualified employer plans)
- Section 4973 (relating to excess costs for certain accounts and annuities)
- Section 4974 (relating to tax on certain accumulations)
- Section 4975 (relating to certain prohibited transactions)
- Section 4978 (relating to certain dispositions)
- Section 4979 (relating to certain excess contributions)
- Section 4979A (relating to tax on prohibited securities allocation)
- Section 4980 (relating to tax on reversion of qualified plan assets to employer, but only from defined contribution plans)
- Section 6057 (relating to annual registration of plans)
- Section 6058 (relating to information required in connection with certain plans of deferred compensation)
- Section 6652(e) (relating to the failure to file annual registration and other notifications by pension plan)
- Section 6652(f) (relating to the failure to file information required in connection with certain plans of deferred compensation)
- Section 7805(b) (relating to the extent to which an IRS ruling or determination letter coming under the statutory provisions listed here will be applied without retroactive effect)

In considering the scope of its proposal, the ACT has excluded pure actuarial aspects of qualified retirement plans recognizing the unique technical expertise required of Enrolled Actuaries. Furthermore, the ACT has included Section 72, primarily because of plan loan issues and taxation of distribution issues.

**E. Changes to Circular 230**

Implementing the proposal would require changes to Circular 230, to

- Define the scope of practice
- Specify an examination and enrollment procedure
- Include changes to incorporate standards of conduct, and
- Make other conforming changes throughout Circular 230

Appendix A outlines our proposed changes to Circular 230. It is our understanding from OPR that a current regulation project is pending that could perhaps include our changes if accepted by the Commissioner and Treasury Department. This would significantly improve the implementation schedule. (See Timing Section below for additional comments on our perceived need for an expedited implementation process.)

**F. Standards of Conduct**

An important ramification of the ACT's recommendation is the imposition of Circular 230 standards of conduct and ethics on the ERPAs. Under the proposal, the same standards of conduct which currently apply to Enrolled Agents would also apply to ERPAs.

**G. Practice of Law**

The ACT intends that this report not be construed as intruding on a state's right to regulate the practice of law. As is true today, the practice of law remains regulated by state action. Enrollment as an ERPA would not authorize a person to engage in the practice of law. See also Circular 230 § 10.32.

**H. Timing**

The time frame for implementation was carefully considered by the ACT. In addition to a desire to "quickly" provide retirement plan practitioners with the means to fully represent their clients before the IRS, the ACT also recognizes the high priority placed upon the increased professional responsibility by Commissioner Everson. We realize this recommendation will require the support and assistance of Commissioner Everson, TE/GE Commissioner Steven T. Miller, the OPR, the Employee Plans Division, Chief Counsel's Office, and the Department of Treasury. While we realized there are a number of steps necessary to implement our recommendations, we also feel a compelling sense of urgency for the following reasons:

- Audits and voluntary correction programs are ongoing and VCP filings are increasing,
- Determination letter filings for prototype plans are expected to nearly double in Fiscal Year 2009, and



- ERPA's could be integrally involved in the Department of Labor's new program for electronic filing of Forms 5500.

Therefore, the ACT has targeted October 2006 as the date by which enrollment of ERPA's should begin.

The specific data used to support our conclusion includes the following:

- An enhanced Employee Plans audit program, thereby requiring additional representation by retirement plan practitioners.
- An increasing need for services associated with VCP filings, recognizing that VCP filings in fiscal 2004 more than doubled the filings in fiscal 2003 (2,268 compared to 1,011). Filings in the first six months of fiscal 2005 suggest fiscal 2005 will equal fiscal 2004 numbers.
- The projected workload in determination letter requests for EGTRRA amendments submitted by retirement plan practitioners. The following table represents anticipated filings under the new staggered determination letter program:

Form	FY '05	FY '06	FY '07	FY '08	FY '09	FY '10
5300	8,000	8,000	10,800	7,800	7,800	7,800
5307	16,000	16,000	16,000	16,000	34,894	58,974
5310	8,000	8,000	8,000	8,000	8,000	8,000
Total	32,000	32,000	34,800	31,800	50,694	74,774

- An ability to "Fast Track" the Circular 230 amendment process, by associating its recommendations with other pending Circular 230 amendments.
- During part of this period (February 2005 thru January 31, 2008), master and prototype plans, and volume submitter plans, will also be processed (approximately 18,000 total).

**I. Additional Comments on Scope of Proposal**

In its deliberations, the ACT considered whether it should expand its recommendations to include 403(b) and 457(b) plans. Ultimately the ACT decided to limit its recommendations to 401(a) plans. This decision was primarily based on the following:

- 403(b) and 457(b) plans currently have no standardized determination letter process – e.g., no standardized qualification filing.
- 457(b) and 403(b) governmental plans have no annual filings.
- Coverage of these plan areas would necessitate a broader examination design and potentially delay and complicate test design.
- Many of the existing educational programs spend little or no time on these plan types.
- Most practitioners currently have no exposure to these types of plans and do not intend to work on these areas.

In the event the IRS develops a voluntary determination letter program and/or standardized annual filings, expanding the scope of practice to include 403(b) and 457(b) governmental plans becomes attractive. At this time, the ACT merely acknowledges this consideration and leaves to the IRS and OPR the determination of when this may become appropriate.

The ACT also considered whether the scope should include welfare plans. However, since these plans are generally not within the jurisdiction of TE/GE, we concluded that they should not be included within our recommendation.

## VI.

### TRANSITION ISSUES

#### A. No Need for Transition Relief

The ACT considered whether temporary ERPA status should be granted during the interim period prior to the programs implementation. For the reasons discussed below, the ACT does not recommend establishing transition relief.

Based on discussions with representatives of OPR and the Employees Plans Division of TE/GE, it is estimated that the Amendment of Circular 230 and the development of an examination program for ERPAs will require 18 to 30 months. Given the length of time needed to implement the program, the ACT believes any additional recommendations (including transitional structures) may further delay the implementation process.

The ACT recognizes that any program of transition relief would also require the establishment of an administrative process to qualify individuals for this temporary

status. The resources required to establish and administer qualification under a temporary status program would likely utilize the same resources that will be needed to establish the permanent ERPA examination and enrollment program. Recognizing the finite and limited resources which will be available to implement the ACT's recommendations, the ACT does not believe it will serve the long term best interests of the IRS, the community of affected practitioners or the employers maintaining qualified retirement plans to recommend a transition program which would lengthen the time needed to establish a permanent ERPA program.

Among the transition processes reviewed by the ACT was the process utilized by the Enrolled Actuaries after the passage of ERISA. ERISA §3042 mandated that the Joint Board for the Enrollment of Actuaries (the "Joint Board") enroll individuals as enrolled actuaries on and after January 1, 1976, but provided that the Joint Board could "provide for the temporary enrollment for the period ending on January 1, 1976, of actuaries under such interim standards as it deems adequate." Because the Joint Board had less than 16 months to establish a program for the enrollment of actuaries and had no preexisting process on which to base an enrollment program, the Joint Board had no choice but to establish standards that relied on prior demonstrations of pension actuarial competency. In fact, ERISA §3042 specified several types of educational competency and prior experience, other than a Joint Board administered examination, that would satisfy the standards and qualifications to be established by the Joint Board for determining whether an individual should qualify as an enrolled actuary.

Since the circumstances surrounding the establishment of the Enrolled Actuary program were significantly different from those applicable to individuals who currently are not authorized to practice before the IRS in the qualified retirement plan area, the ACT does not believe the transitional processes established for Enrolled Actuaries serve as a reason or a basis for requiring the establishment of transitional relief for ERPA's.

Furthermore, the ACT examined current procedures used by practitioners to make submissions and communicate with the IRS regarding qualified retirement plan matters. In the Volume 4/Fall 2004 issue of the Employee Plans News published by the TE/GE, the IRS discussed the options available to practitioners who are not enrolled to

practice before the IRS with respect to two principal qualified retirement plan programs – the Determination Letter program and the EPCRS program. (See Exhibit D). The IRS stated that "[a]lthough an unenrolled preparer does not have the authority to sign documents or submissions on behalf of the plan sponsor, an unenrolled preparer can still submit items to the IRS or take a role in the Determination Letter or EPCRS processes." The IRS noted further that by filing a properly executed Form 8821, Tax Information Authorization, an unenrolled preparer can (i) provide information to and receive information from the IRS regarding a qualified retirement plan, (ii) receive copies of correspondence from the IRS, submit information requested by the IRS and discuss matters with the IRS in connection with either a Determination Letter application or a EPCRS submission, and (iii) submit an application on Form 5558 for an extension of time for filing certain employee plan returns. The principal function the unenrolled preparer cannot perform is to make decisions on behalf of a plan or plan sponsor regarding the Determination Letter application or the EPCRS submission. These decisions must remain with the plan or plan sponsor and be made in person or in writing.

In light of the options currently available through use of a Form 8821, the ACT concluded that Form 8821 provides an adequate interim substitute to prevent the disruption of the current operation and administration of qualified retirement plans, minimize the disruption of practitioners businesses, and reduce the additional burdens which might otherwise accrue to plan sponsors. The ACT does not believe the lack of transition relief will prevent these practitioners from performing most of the activities which are part of their core business.

## **VII.**

### **OTHER IMPLICATIONS**

#### **A. General Comments**

This section of the ACT's report considers other possible implications of establishing the ERPA designation. These implications include:

- The ERPA submitting electronic filings on behalf of a plan sponsor
- The ERPA signing Form 5500 as preparer
- The effect on education and credentialing.

Recognizing the ERPA designation would also establish a pool of experts who could submit electronic filings, or sign Form 5500 as preparers, if and when such activities are required. Existing education and credentialing programs would probably be modified slightly to take into account the requirements of qualifying as an ERPA.

**B. Electronic Filings**

The ACT is cognizant of efforts at the Department of Labor and IRS to move to mandatory electronic filing of Form 5500 and its attachments. While this proposal is still in the preliminary stages, mandatory electronic filing could be mandated by the time the IRS initiates the ERPA program. Small employers may find themselves burdened with yet another mandatory process which requires them to expend time and effort to understand and implement, yet is required only once per year. Small employers would likely prefer to rely on third parties to complete these filings on their behalf, and might simply turn over the confidential filing codes to their retirement plan practitioner to complete the filing.

The DOL could authorize ERPAs to file a Form 5500 on behalf of a plan sponsor, and such small employers could feel comfortable that they are relying on a competent professional to complete the filing process. The ACT believes that many small employers will not understand the legal implications of turning over their filing codes to a third party, and that small employers should not be unwillingly burdened by learning a filing process for a one-time annual return. Allowing ERPAs to file Form 5500 on an employer's behalf should improve accuracy of the forms without significantly increasing the burden on employers.

**C. Form 5500 Preparers**

At times, Form 5500 is prepared by a third party or an employee of the plan sponsor, and then signed by someone who has little or no understanding of the contents of the form. Preparers of income tax returns are required to co-sign the form, and it may be only a matter of time before preparers of information returns like Form 5500 may be required to do the same. Alternatively, the IRS may wish to require preparers of Form 5500 to sign the Form as preparer, and apply to such preparers the standards of conduct required of all unenrolled preparers. Establishing such a requirement in the law would be consistent with the current objectives of increasing

accountability among practitioners and increasing tools for enforcement against practitioners engaged in fraudulent or deceptive practices. If and when the law requires preparers to sign Form 5500, the category of ERPA would provide a ready-made group of professionals qualified to prepare and sign Form 5500. The ACT believes that many of the practitioners who would pass an ERPA examination are already preparing or directing the preparation of Form 5500 for their clients.

**D. Education and Credentialing**

The creation of the ERPA designation would likely affect existing education programs sponsored by professional organizations. The ACT believes that these sponsors are likely to expand their programs to provide course manuals necessary for practitioners to both pass an ERPA examination and meet their continuing education requirements. The ACT does not expect such sponsors to abandon their current programs, which serve very critical education needs.

Several professional organizations sponsor their own credentialing programs for practitioners. (See Appendix B.) The ACT believes that such programs could be enhanced by the ERPA designation. Professionals would seek to qualify as ERPAs both to better serve their clients and to enhance their professional stature. Because the coursework for existing credentialing programs is likely to parallel (at least in part) the coursework taken to prepare for the ERPA examination, a practitioner could easily choose to complete one or more professional certifications at the same time he or she is preparing for the ERPA examination. Practitioners or organizations interested in this implication might consider the development and expansion of credentialing programs for actuaries after the Enrolled Actuary category was established in 1976.

**VIII.**

**CLOSING**

It was truly a pleasure to work with all the TE/GE staff and the OPR staff on this project. The many thoughtful comments we received were very helpful as we evaluated alternatives and the need for the new category.

## **APPENDIX A – RECOMMENDED CHANGES TO CIRCULAR 230**

### **1. Section 10.3 would be amended by insertion of new subsection (e) and renumbering of current subsections (e), (f) and (g).**

#### **(e) Enrolled retirement plan agent.**

1. Any individual enrolled as an Enrolled Retirement Plan Agent pursuant to this part who is not currently under suspension or disbarment from practice before the IRS may practice before the IRS.
2. Practice as an Enrolled Retirement Plan Agent is limited to representation with respect to issues involving the following statutory provisions in Title 26 of the United States Code Sections: 72 (relating to taxation of distributions from plans), 401 (relating to qualification of employee plans), 402 (relating to taxability of certain trusts), 403(a) (relating to whether an annuity plan meets the qualification requirements), 404 (relating to deductibility of employer contributions), 404(a)(2) (relating to deductibility of employer contributions), 408 (relating to various individual retirement accounts and programs), 410 (relating to minimum participation standards), 411 (relating to minimum vesting standards), 412 (relating to funding, but only as to defined contribution plans), 413 (relating to application of qualification requirements for collectively bargained plans and for plans maintained by more than one employer), 414 (relating to definitions and special rules with respect to the employee plan area), 415 (relating to limitations on contributions and benefits under qualified plans), 416 (relating to special rules for top-heavy plans), 417 (relating to survivor annuities), 512 (relating to unrelated business income), 513 (relating to unrelated trade or business), 514 (relating to unrelated debt financed income), 4972 (relating to tax on nondeductible contributions to qualified employer plans), 4973 (relating to excess costs to certain accounts and annuities), 4974 (relating to tax on certain accumulations), 4975 (relating to certain prohibited transactions), 4978 (relating to certain dispositions), 4979 (relating to certain excess contributions), 4979A (relating to tax on prohibited securities allocations), 4980 (relating to tax on reversion of

qualified plan assets to employer, but only from defined contribution plans), 6057 (relating to annual registration of plans), 6058 (relating to information required in connection with certain plans of deferred compensation), 6652(e) (relating to the failure to file annual registration and other notifications by pension plan), 6652(f) (relating to the failure to file information required in connection with certain plans of deferred compensation), 7805(b) (relating to the extent to which an IRS ruling or determination letter coming under the statutory provisions listed here will be applied without retroactive effect).

**2. Section 10.5 would be changed to refer to "Application for enrollment as an enrolled agent."**

**3. A new Section 10.6 would be inserted to cover "Application for enrollment as an Enrolled Retirement Plan Agent."**

1. Form; address. An applicant for enrollment must file an application on Form \_\_, "Application for Enrollment as a Qualified Retirement Plan Agent to Practice Before the IRS," properly executed under oath or affirmation, with the Director of Practice. The address of the applicant entered on Form \_\_ will be the address under which a successful applicant is enrolled and is the address to which the Director of Practice will send correspondence concerning enrollment. An enrolled agent must send notification of any change to his or her enrollment address to the Director of Practice, IRS, 1111 Constitution Avenue, NW, Washington, DC 20224, or at such other address specified by the Director of Practice. This notification must include the enrolled agent's name, old address, new address, social security number or tax identification number, signature, and the date.

2. Fee. The application for enrollment must be accompanied by a check or money order in the amount set forth on Form \_\_, payable to the IRS, which amount constitutes a fee charged to each applicant for enrollment. This fee will be retained by the United States whether or not the applicant is granted enrollment.

3. Additional information; examination. The Director of Practice, as a condition to consideration of an application for enrollment, may require the applicant to file additional information and to submit to any written or oral examination under oath or



otherwise. The Director of Practice will, on written request filed by an applicant, afford such applicant the opportunity to be heard with respect to his or her application for enrollment.

4. Temporary recognition. On receipt of a properly executed application, the Director of Practice may grant the applicant temporary recognition to practice pending a determination as to whether enrollment to practice should be granted. Temporary recognition will be granted only in unusual circumstances and it will not be granted, in any circumstance, if the application is not regular on its face, if the information stated in the application, if true, is not sufficient to warrant enrollment to practice, or if there is any information before the Director of Practice indicating that the statements in the application are untrue or that the applicant would not otherwise qualify for enrollment. Issuance of temporary recognition does not constitute enrollment to practice or a finding of eligibility for enrollment, and the temporary recognition may be withdrawn at any time by the Director of Practice.

5. Appeal from denial of application. The Director of Practice must inform the applicant as to the reason(s) for any denial of an application for enrollment. The applicant may, within 30 days after receipt of the notice of denial of enrollment, file a written appeal of the denial of enrollment with the Secretary of the Treasury or his or her delegate. A decision on the appeal will be rendered by the Secretary of the Treasury, or his or her delegate, as soon as possible.

**4. The ACT further realizes that there would need to be conforming changes throughout Circular 230 (as well as relevant forms) to reflect this new category of enrollment, for example, the ethical standards of § 10.30 et seq.**

## **APPENDIX B – PROFESSIONAL CERTIFICATIONS**

### **I. American Society of Pension Professionals and Actuaries (ASPPA) www.aspa.org**

#### **A. Professional Credentials.**

1. Associated Professional Member (APM). Professionals working in retirement planning with degrees in law, accounting, actuarial science, financial science, insurance, or related disciplines may qualify to be an Associated Professional Member (APM). Professionals from these and other associated disciplines with a minimum of three years experience in pension-related activities are qualified to apply for APM memberships. No ASPPA examinations are required.
2. Qualified 401(k) Administrator (QKA). The Qualified 401(k) Administrator (QKA) credential is offered for retirement plan professionals who work primarily with 401(k) plans. Applicants for the QKA credentials are from various professional disciplines. They typically assist employers and consultants with the recordkeeping, non-discrimination testing and the administrative aspects of 401(k) and related defined contribution plans. Individuals with a minimum of two years of pension related experience, who successfully complete ASPPA's QKA examination series may apply for this credential.
3. Qualified Pension Administrator (QPA). The Qualified Pension Administrator (QPA) credential was created by ASPPA to recognize professionals who are qualified to perform the technical and administrative functions of qualified plan administration. QPAs assist employers, actuaries, and consultants in performing functions such as determination of eligibility benefits, computation of benefits, plan recordkeeping, trust accounting and disclosure, and compliance requirements. Candidates with at least two years of pension-related experience may apply for this credential after successful completion of the ASPPA QPA examination series.
4. Certified Pension Consultant (CPC). The Certified Pension Consultant (CPC) credential is conferred by ASPPA to benefits professionals working in plan administration, pension actuarial administration, insurance, and financial planning. CPCs work alongside employers to formulate, implement, administer and maintain qualified retirement plans. Individuals with at least three years of plan consulting experience may apply to the ASPPA board of directors for CPC credentials. Applicants must demonstrate

competence in specific areas of pension and related employee benefits consulting through completion of the CPC examination series offered by ASPPA.

**B. Courses Offered by ASPPA. Some or all of these courses are a prerequisite for sitting for the various certification examinations:**

1. Pension Administrator Course (PA-1 • PA-2 • PA-3). ASPPA's Pension Administrator (PA) Course consists of three self-study courses and examinations designed to familiarize entry level professionals with the everyday terminology and concepts of a traditional and daily pension administration practice. Each part is self-contained and it is not required that the parts be studied in any particular order. However, ASPPA strongly recommends that students who are new to the pension field take the examinations in order.

Part 1—Fundamentals of Plan Design and Administration I

- (a) Types of plans, common features and qualification;
- (b) Professional roles and fiduciary responsibilities;
- (c) Identification of key employees and highly compensated employees;
- (d) Eligibility requirements;
- (e) Basic trust accounting;
- (f) Allocation of contributions, forfeitures and gains/losses;
- (g) 415 limits and nondiscrimination testing;
- (h) Calculation of projected and accrued benefits in DB plans; and
- (i) Reporting and disclosure requirements.

2. Part 2 — Fundamentals of Plan Design and Administration II

- (a) Types of plan documents;
- (b) Installation, amendment and termination of plans;
- (c) Plan document/record retention;
- (d) Law changes and corrective actions;
- (e) Processing participant elections;
- (f) Ongoing employee communication;
- (g) Processing plan distributions and loans;
- (h) Taxation of distributions; and
- (i) Qualified domestic relation orders.

3. Part 3 — Daily Valuation Environment

- (a) Fiduciary liability and ERISA/404(c);
- (b) Investment fees and expenses;

- (c) Mutual fund trading practices;
- (d) Processing daily transactions;
- (e) Paperless communications;
- (f) Transferring plans to a daily recordkeeping system; and
- (g) Audits, error corrections and ethics.

4. Defined Contribution Administrative Issues—Basic Concepts (DC-1)

The law and regulations that govern the operation and qualification of retirement plans in general, including:

- (a) Plan qualification requirements;
- (b) Types of plans;
- (c) Requirements for eligibility and participation;
- (d) Highly compensated employees;
- (e) Key employees and top heavy plans;
- (f) Requirements for coverage;
- (g) Contributions and allocations;
- (h) Deductibility and minimum funding;
- (i) Requirements for vesting;
- (j) Plan terminations and amendments; and
- (k) Annual reporting requirements.

5. Defined Contribution Administrative Issues—Compliance Issues (DC-2)

The law and regulations that govern the operation and qualification of 401(k) plans, employer contribution allocation methods and distribution issues in general, including:

- (a) 401(k) basics;
- (b) 401(k) coverage and nondiscrimination;
- (c) Corrections of failed ADP/ACP tests;
- (d) Special ADP/ACP testing rules;
- (e) Safe harbor 401(k) and SIMPLE-401(k) plans;
- (f) ERISA §404(c);
- (g) Defined contribution allocation methods;
- (h) Distributions;
- (i) Taxation; and
- (j) Participant loans.

6. Defined Contribution Administrative Issues—Advanced Topics (DC-3)

The law and regulations that govern corporate and other employer entities, nondiscrimination and coverage testing, compensation, ESOPs, fiduciary standards, prohibited transactions, life insurance and distribution issues in general, including:

- (a) Controlled groups;
- (b) Affiliated service groups;
- (c) Other employer situations;
- (d) Compensation;
- (e) Average benefits test and other special rules;
- (f) Nondiscrimination;
- (g) Employee stock ownership plans;
- (h) Fiduciary standards;
- (i) Prohibited transactions; and
- (j) Life insurance and distributions.

7. Administrative Issues of Defined Benefit Plans (DB) Administration and consulting for defined benefit plans, including:

- (a) Benefit calculations and benefit limitations;
- (b) Nondiscrimination and permitted disparity rules;
- (c) Plan terminations and PBGC coverage;
- (d) Funding methods, funding requirements and funding limitations;
- (e) Variations such as IRC §412(i) plans, cash balance plans and floor offset plans; and
- (f) FASB reporting

**II. NATIONAL INSTITUTE OF PENSION ADMINISTRATORS (NIPA)**  
**[www.nipa.org](http://www.nipa.org)**

**A. Professional Credentials.**

1. Accredited Pension Administrator (APA). The Accredited Pension Administrator (APA) designation is earned by the successful completion of six study courses and examinations covering all aspects of plan administration. Any person may take APA examinations, but two years of experience in plan administration is required for the designation. The APA is maintained by annually completing 15 hours of continuing education and current NIPA membership. Potential APAs include pension administrators, retirement relationship managers, and ERISA Compliance specialists.
2. Accredited Pension Representative (APR). The Accredited Pension Representative (APR) designation is earned by the successful completion of two study courses and examinations covering the fundamentals of retirement plans with an emphasis on defined contribution plans and investment philosophy. The APR also requires an NASD Series 6, 7, 65, 66, 24, or an insurance license, and is maintained by annually completing 10 hours of

continuing education and current NIPA membership. Potential APRs include retirement plan personnel, financial consultants / planners, and Registered Investment Advisors.

**B. Courses Offered by NIPA. NIPA offers a variety of courses to prepare practitioners for its certification examinations:**

1. APA Course 1 Overview of Retirement Plans

An Overview of the Retirement Field  
Marketing Qualified Plans: Meeting Client Needs and Objectives  
Defined Benefit, Cash Balance, Target Benefit, and Money  
Purchase Pension Plans  
Profit Sharing, Stock Bonus and ESOPs  
401(k), 403(b) and Section 457 Plans  
Individual Retirement Plans  
Simplified Employee Pension Plans and SIMPLEs  
Coverage, Eligibility, and Participation Rules  
Benefit Formulas and Employee Contributions  
Loan, Vesting, and Retirement Age Provisions  
Death and Disability Benefits; Top-Heavy Rules  
Qualified Plan Administration  
Plan Termination

2. APA Course 2 Fundamentals of Qualified Plans

Eligibility for Plan Purposes-Part A  
Eligibility for Plan Purposes-Part B  
Compensation  
Highly Compensated and Key Employees  
Coverage  
Minimum Participation  
Nondiscrimination in Contributions and Benefits  
Vesting  
Top-Heavy Rules  
Section 415-Part A  
Section 415-Part B  
404 Limits  
401(k) Plans

3. APA 3 401(k) Plans

Introduction to 401(k) Plans  
401(k) Plan Design  
Safe Harbor 401(k) Plans  
Simple 401(k) Plans

401(k) Plan Document and Contribution Limits  
Plan Services and Service Providers  
Participation Communication and Education  
General Nondiscrimination Testing  
ADP Testing  
ACP Testing  
401(k) Plan Alternatives (Part A)  
401(k) Plan Alternatives (Part B)

4. APA 3 DB - Defined Benefit Plans

Interest Calculations  
Defined Benefit Formulas and Accrual Methods  
Calculation of Accrued Benefits and Present Values  
Maximum Benefits Under IRC 415(b)  
Nondiscrimination Under IRC 401(a)(4)  
Permitted Disparity in Defined Benefit Plans  
Actuarial Funding Methods-Part A  
Actuarial Funding Methods-Part B  
Maximum Deductible Contributions and Full Funding Limitations  
Minimum Funding Standards  
FASB for the Pension Administrator  
Hybrid Plans  
Cross Tested Plans Under IRC 401(a)(4)

5. APA Course 4 - Selected Topics in Qualified Plans

Basic Business Law Principles for Pension Administrators  
Understanding IRS Communications  
Qualified Joint and Survivor Annuity Requirements  
Programs to Correct Operational Plan Defects  
Nonqualified Deferred Compensation Plans  
Controlled Groups  
Affiliated Service Groups  
Separate Lines of Business  
Non-Traditional Employee Relationships  
Fiduciary Responsibility  
Fiduciary Responsibility  
Prohibited Transactions  
Unrelated Business Taxable Income

6. APA Course 5 - Qualified Plan Administration

Participant Loan Rules  
Administering Direct Rollovers and Mandatory Withholding  
Qualified Domestic Relations Orders (QDROs)

Plan Investments  
Reconciliation of Trust Assets  
Retirement Plan Issues in Mergers and Acquisitions  
PBGC Premium Payment Forms and Requirements  
Obtain Qualification and Plan Amendments  
Plan Terminations-Part A  
Plan Terminations-Part B  
Reporting and Disclosure-Part A  
Reporting and Disclosure-Part B  
Cafeteria Plans

7. APA Course 6 - Distributions From Qualified Plans

In-Service Distributions; Employee Contribution Withdrawals  
Loans  
QDRO Distributions; PS-58 Costs  
Required Minimum Distributions  
Tax Deferred Annuities and Employer Securities  
Taxation of Nonperiodic Payments-Part A  
Taxation of Nonperiodic Payments-Part B  
Taxation of Periodic Payments  
Direct Rollovers and Rollovers-Part A  
Direct Rollovers and Rollovers-Part B-Plan To Plan Transfers  
Federal Income Tax Withholding; Reporting Distributions  
Additional Taxes  
International Tax Issues

**III. INTERNATIONAL FOUNDATION OF EMPLOYEE BENEFIT PLANS (IFEBCP)**  
**[www.ifebc.org](http://www.ifebc.org)**

**A. Credentials**

1. Certified Employee Benefits Specialist (CEBS). The CEBS program offers benefits and compensation professionals several levels of certification. The body of knowledge within the CEBS program focuses on group benefits, retirement and compensation. Each track delivers specialized knowledge in its own unique area and leads to a specialty designation following completion of the required number of courses. When combined, the three tracks form a comprehensive, integrated curriculum in total compensation. To earn the CEBS credential, candidates must complete eight courses—six required and two elective.
2. Specialty Designations. The IEBEF offers specialty certifications. To earn a specialty designation, candidates must complete the



required courses within each track. All of the specialty track courses may also be applied toward earning the CEBS designation.

- Compensation Management Specialist (CMS) (focus on compensation concepts, human resources, and executive compensation)
- Group Benefits Associate (GBA) (focus on health and welfare benefits)
- Retirement Plans Associate (RPA) (focus on retirement plans, asset management and financial planning)

**B. Course Offerings:**

1. Six Required Courses.

Course 1—Employee Benefits: Concepts and Health Care Benefits  
Course 2—Employee Benefits: Design, Administration and Other Welfare Benefits

Course 3—Retirement Plans: Basic Features and Defined Contribution Approaches

Course 4—Retirement Plans: Defined Benefit Approaches and Plan Administration

Comp 1—Compensation Concepts and Principles

Course 8—Human Resources and Compensation Management

2. Two Electives (Any two of the following CEBS courses)

Course 7—Asset Management

Course 9—Health Economics

Comp 2—Executive Compensation and Compensation Issues

PFP1—Personal Financial Planning 1: Concepts and Principles

PFP2—Personal Financial Planning 2: Tax and Estate Planning Techniques

**IV. INTERNATIONAL FOUNDATION FOR RETIREMENT EDUCATION (InfRE)  
[www.infre.org](http://www.infre.org)**

**A. Credentials:**

1. Certified Retirement Counselor (CRC). The Certified Retirement Counselor (CRC) designation is offered to individuals who have a minimum of two years of professional experience, have completed a four-course program and passed an examination, and have two professional references.

2. Certified Retirement Administrator (CRA). The Certified Retirement Administrator (CRA) designation is offered to individuals who have a minimum of three years of professional experience, have completed a four-course program and passed an examination, and have two professional references.

**B. Course Offerings:**

1. Course #1: Fundamentals of Retirement Planning. This course is the foundation for all the other courses in the CRC series. It covers the basic tools of financial planning with a strong emphasis on how they can be used to prepare for retirement. The course provides techniques to identify, prioritize and meet retirement goals. It takes a close look at how to plan for retirement at the different stages of life. Students will learn methods for motivating and educating members and employees on the need to save for retirement, and the importance of taking personal responsibility for their own financial futures. Topics include: cash management; debt management; tax and estate planning strategies; how time affects the value of money; budgeting and the different life cycle stages; financial inventory and organization; integrating employees' plans with spousal benefits; other sources of retirement income besides the employer's plan.
2. Course #2: Fundamentals of Investments. Familiarity with the language of investments is critical to effective retirement counseling. This course provides the retirement counselor with the basic concepts and terminology needed to help participants/employees invest for their longer-term retirement goals. Topics include the basic investment instruments: common and preferred stock; bonds; short-term instruments; mutual funds; convertibles; annuities and guaranteed contracts; and the various fee structures associated with these investments. Managing risk through the use of diversification, asset allocation and portfolio management is covered. It also presents the important aspects of time horizon and goal-appropriate investing. Emphasis is on training the counselor to assist participants in feeling comfortable with the investment decisions that must be made to achieve a financially worry-free retirement. The course includes a discussion of how to present the information in the course to participants.
3. Course #3: Fundamentals of Retirement Plan Design. This course presents an overview of the various retirement plans in use today. Students will learn the key terminology and concepts, as well as the basic features of qualified and non-qualified plans. The course provides a basic understanding of the government regulations

(ERISA and the Internal Revenue Code) that determine how retirement plans must operate. In addition, Social Security and Medicare are covered. Topics include: the definition of qualified and non-qualified plans; the difference between defined benefit and defined contribution plans; advantages of each plan to employers and employees; the rules covering qualified plans, including eligibility and contribution limitations; payment options at retirement and the rules governing distributions; and plans for individuals (IRAs) and the self-employed. The study guide will help the retirement professional translate this complex and often confusing information to participants of various and backgrounds.

4. Course #4: Fundamentals Of Counseling; Communications & Ethics. The delivery of information and education to the employee/participant is the primary function of the retirement counselor. This course teaches both basic and advanced skills for effective and ethical communication. Students will learn the basic principles of communication, including listening skills; non-verbal communication; gender differences in communication; etc. The course covers how to look beyond the individual employee/participant to consider broader issues such as their financial history, family and extended family considerations, etc. Company-wide considerations are addressed, such as who the audience and stakeholders are; ethnic and cultural issues; workforce demographics; etc. The course includes practical tools for designing an education program, such as print media; presentations; seminars and workshops; voice response systems; websites, etc., and the various considerations for both large and small employers. The course focuses on ethics and professionalism as the foundation for good communication. Students will learn the InFRE Code of Ethics which provides a framework for making ethical choices. Case studies allow students to apply the InFRE Code to the very real ethical issues counselors may face.

## **V. AMERICAN BANKERS ASSOCIATION [www.aba.com](http://www.aba.com)**

### **A. Credentials**

1. Certified Retirement Services Professional (CRSP). The Certified Retirement Services Professional (CRPS) designation requires a minimum of three (3) years experience in ERISA and IRS Code/Regulations experience and completion of an ICB approved employee benefit /retirement services training program; or five (5) years experience in ERISA and IRS Code/Regulations experience. One letter of recommendation from your manager attesting to your

qualifications for certification including your ERISA and IRS Code/Regulations experience. ERISA and IRS Code/Regulations experience is defined as employee benefit services experience including relevant experience at a financial institution, a law firm, accounting firm, employee benefit consulting firm, a plan sponsor or a service provider. Each candidate must sign ICB's Professional Code of Ethics statement.

**B. Course Offerings.** The ICP does not require completion of specific courses, but an applicant must pass an examination. The examination requires knowledge of the following matters:

1. Plan Design and Type. An applicant must have a thorough understanding of plan types (i.e., defined benefit and defined contribution plans), their key features, legal requirements applicable to each plan type and the tax elements for each plan. An applicant's familiarity with the design and administration of plan types must range from plan installation to plan termination.
2. Laws and Regulations. An applicant must understand the legal and regulatory issues applicable to the employee benefits industry. Your knowledge must encompass in-depth comprehension of ERISA and the fiduciary duties and liability under ERISA as well as IRS, SEC, OCC (Reg 9), FDIC and PBGC requirements. In addition, an applicant must understand trustee and plan administrator responsibilities.
3. Investments. An applicant must have knowledge of investment fundamentals, types of investment vehicles and their associated characteristics, objectives, risks, proxy handling, participant directed plans, investment strategies and handling of participant loans. Furthermore, an applicant must possess a basic understanding of performance measures and securities lending as it relates to a plan's investment portfolio.

**APPENDIX C – CREDENTIALING PROGRAMS FOR RETIREMENT PLANS PROFESSIONALS**

<u>ORGANIZATION</u>	<u>DESIGNATION</u>	<u>ESTIMATED NUMBER</u>	<u>COURSE REQUIREMENTS</u>	<u>EXAMINATION REQUIREMENTS</u>	<u>EXPERIENCE REQUIREMENTS</u>	<u>CPE REQUIREMENTS</u>
International Foundation of Employee Benefit Plans	CEBS	10,500	8 courses on various employee benefits topics	8 proctored exams	None	None
	RPA	1,600	4 courses on various employee benefits topics	4 proctored exams	None	None
<b>Subtotal</b>		<b>12,100</b>				
American Society of Pension Professionals and Actuaries	QKA		5 qualified retirement plan courses (DC plans)	3 online and 2 proctored exams	2 Years	40 Hours/2 Years
	QPA		7 qualified retirement plan courses (DB and DC plans)	3 online and 4 proctored exams	2 Years	40 Hours/2 Years
	CPC		9 qualified retirement plan courses (DB and DC plans)	3 online and 6 proctored exams	3 Years	40 Hours/2 Years
<b>Subtotal</b>		<b>3,400</b>				
National Institute of Pension Administrators	APR		2 qualified retirement plan courses (DC plans)	2 proctored exams	must possess NASP series 6, 7, 65, 66, 24 licenses	10 Hours/1 Year
	APA	600	6 qualified retirement plan courses (DC plans principally)	6 proctored exams	2 Years	15 Hours/1 Year
International Foundation for Retirement Education	CRA CRC		4 qualified retirement plan courses	4 proctored exams or 1 comprehensive exam if applicant completes prep course offered by INFRE	3 Years	15 Hours/1 Year
<b>Subtotal</b>		<b>1,600</b>				
Society of Professional Administrators and Recordkeepers	ARPC	unknown	3 online self study courses and a one-day classroom session (sales oriented)	None	None	Attend SPARK Conference and participate in 2 online sessions
	ARPS	unknown	3 online self study courses and 2-day classroom course (administration oriented)	None	None	Attend SPARK Conference and participate in 2 online sessions
World at Work	CBP	1,200	9 2-day courses on various employee benefits topics	9 proctored exams	None	12 Hours/3 Years
American Bankers	ABA	unknown	1 training course on various	1 proctored exam	5 Years or 3 Years	30 Hours/3 Years

Association			retirement plan topics		with training courses	
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## **APPENDIX D – EXCERPT FROM EMPLOYEE PLAN NEWS, FALL 2004**

Excerpt from the IRS website concerning unenrolled preparers,  
at <http://www.irs.gov/retirement/article/0,,id=129553,00.html>

### **Unenrolled Preparers, Form 2848 and the IRS**

Taxpayers may use Form 2848, *Power of Attorney and Declaration of Representative*, to authorize another person to represent the taxpayer before the IRS. This person must be eligible to practice before the IRS but taxpayers have occasionally submitted the forms listing ineligible representatives. IRS practice has been to treat these invalid powers of attorney as tax information authorizations, which permit third parties to receive information about the taxpayer's account, but not to represent the taxpayer before the IRS. Beginning April 1, the IRS discontinued this practice and began rejecting Forms 2848 listing an ineligible representative. The IRS took this step to clarify that taxpayers should use Form 2848 for the sole purpose of authorizing an eligible person to represent them before the IRS and to discourage ineligible persons from using the form in attempting to represent taxpayers. As a result of this change in practice, questions have been raised regarding the role an unenrolled preparer may now play in submissions to EP.

### **Preparation of Tax Returns and EP Examinations**

The general rules regarding the practice of unenrolled preparers before the IRS are set forth in Circular 230 and Rev. Proc. 81-38. Circular 230 provides that individuals who are not CPAs, attorneys, enrolled actuaries, or enrolled agents, may practice as unenrolled preparers before the IRS to the extent they prepared the tax returns at issue. Rev. Proc. 81-38 (issued as Publication 470, *Limited Practice Without Enrollment*) specifically addresses the role of an unenrolled preparer when dealing with the IRS with respect to tax returns. Rev. Proc. 81-38 states that an unenrolled individual who signs a return may act as the taxpayer's representative but this representation may only encompass matters concerning the tax liability for the taxable year covered by the return. According to these procedural rules, unenrolled return preparers may only represent a taxpayer on the examination of a return that they prepared. In addition, Rev. Proc. 81-38 specifies that some acts are expressly beyond the scope of the authority, including: executing claims for refund; receiving checks in payment of any refund of taxes, penalties, or interest; executing closing agreements with respect to a tax liability or specific matter; or executing waivers of restriction on assessment or collection of a deficiency in tax.

### **EPCRS and the Determination Letter Program**

Rev. Proc. 2004-6 is the current guidance for submitting matters under the Determination Letter program. Section 6.06 of Rev. Proc. 2004-6 expressly states that Section 9 of Rev. Proc. 2004-4 (regarding requests for letter rulings) is applicable to requests for determination letters. Section 9.02(10) of Rev. Proc. 2004-4 states that "(t)he request for a letter ruling or determination letter must be signed and dated by the

taxpayer or the taxpayer's authorized representative.” Section 9.02(11)(f) states that an unenrolled return preparer may generally not represent a taxpayer in connection with a letter ruling, determination letter or a technical advice request. Taken in conjunction with Rev. Proc. 81-38, Rev. Procs. 2004-4 and 2004-6 limit the ability of an unenrolled preparer to represent a plan sponsor in the determination letter process.

Under Revenue Procedure 2003-44, the same rules apply to EPCRS. As with the Determination Letter program under Rev. Proc. 2004-6, section 10.12 of Rev. Proc. 2003-44 provides that the rules regarding the authority to sign an EPCRS submission and to appear before the IRS in connection with a submission are the same as for requests for letter rulings. Accordingly, the same restrictions applicable to the Determination Letter program also apply to EPCRS.

### **Limited Role for Unenrolled Preparers**

So where does this leave unenrolled preparers with respect to the EP Determination Letter program and EPCRS?

Although an unenrolled preparer does not have the authority to sign documents or submissions on behalf of the plan sponsor, this does not mean that an unenrolled return preparer can no longer submit items to the IRS or take a role in the Determination Letter or EPCRS processes. An unenrolled preparer may use a Form 8821, *Tax Information Authorization*. If a Form 8821 is properly executed an unenrolled preparer may:

1. Provide information regarding a plan to the IRS and receive tax information from the IRS regarding a plan;
2. Receive copies of correspondence from the IRS and submit information requested by the IRS (such as participant data, asset information, etc.) as part of the review of an EPCRS submission or a determination letter application;
3. Discuss matters raised relative to a determination letter application or an EPCRS submission with EP personnel as long as any decisions regarding the application or the submission are made by the taxpayer, either in person or in writing;
4. Submit an application for an extension of time on Form 5558, *Application for Extension of Time to File Certain Employee Plan Returns*.

### **Current Use of Form 2848**

Previously, IRS employees accepted a Form 2848, Power of Attorney and Declaration of Representative, as a substitute for Form 8821, but as of April 1, 2004, Forms 2848 are no longer accepted where the representative is an unenrolled return preparer. Determination letter applications or EPCRS submissions submitted by an unenrolled preparer prior to that time will be treated according to prior customs. For all applications submitted after March 31, 2004, the rules as outlined in the revenue procedures will apply.



As a result, unenrolled return preparers may not use Form 2848 to receive confidential information about their clients. Attorneys, CPAs, enrolled agents, enrolled actuaries and other individuals authorized to practice before the IRS will continue to use Form 2848 as they have in the past. Unenrolled preparers, however, would instead use Form 8821.

### **Future Solution?**

The Advisory Committee on Tax Exempt and Government Entities (ACT) and EP recognize the important role played by benefits professionals who are not currently permitted to represent taxpayers in their dealings with EP, but upon whom many taxpayers depend for their expert advice regarding plan establishment and administration. Accordingly, the ACT is currently considering the advisability of a recommendation that would permit enrollment for limited purposes to applicants who can demonstrate special competence in EP matters. The ACT is gathering information from interested parties in the employee plans community in an effort to determine whether such a recommendation would not only serve the oversight needs of the IRS with respect to professional and compliant service providers for employee plans, but also extend representational rights and responsibilities to a community that has provided valuable services to employers who maintain plans. Comments may be emailed to [tege.act@irs.gov](mailto:tege.act@irs.gov).



**Advisory Committee on  
Tax Exempt and Government Entities  
(ACT)**

**Project “IMPROVE”**

- *Informative Materials Prescribe Responsibilities and Obligations Very Early***
- *Recommendations to Enhance the Compliance of Newly Formed Charities***

*“Nonprofit organizations, like nightclubs, either last a long time or they go out of business.”*

Emmett D. Carson  
President, Minneapolis Foundation

**Ann Bittman and George Vera, Project Leaders**  
**Victoria Bjorklund**  
**Deirdre Dessingue**  
**Julie Floch**  
**Suzanne McDowell**

**June 8, 2005**

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## I. EXECUTIVE SUMMARY

The years immediately following recognition of exemption are crucial to an organization's understanding and development of good compliance habits. During these early years, new public charities ("charities") are likely to face a series of transitions, each of which presents compliance challenges.

The ACT believes that the vast majority of exempt organizations want to comply with the requirements of their exempt status. Unfortunately, despite significant educational and outreach efforts by the IRS Exempt Organizations division ("EO"), some charities fail to obtain the information necessary to do so. Too often, newly-formed charities pass through these transitions with insufficient guidance. Ill-informed charities, no matter how well intentioned, are more likely to fall into patterns of noncompliance and are at increased risk of manipulation by unscrupulous persons and promoters.

We offer the following recommendations to improve the compliance of newly-created charities:

- 1) **Enhance the quantity and quality of EO contacts with charities.** *The ACT recommends that EO pursue a range of opportunities to increase the number of contacts with charities and improve the quality of those contacts:*
  - a. *Require additional contact information on Form 1023 and Form 990*
  - b. *Enhance EO Call Center message options*
  - c. *Expand FAQs on EO website*
  - d. *Continue to pursue electronic filing initiatives, both for the Form 990 and the Form 1023*
- 2) **Lower the Form 990 filing threshold to \$5,000. Require charities, not otherwise exempt from the Form 990 filing requirement and having gross receipts between \$5,000 and \$25,000, to complete and submit a modified version of the top section of Form 990-EZ.** *The ACT recommends that the Secretary of the Treasury rescind the discretionary exemption for charities with gross receipts normally below \$25,000 and reinstate the \$5,000 statutory filing threshold. Charities with gross receipts between \$5,000 and \$25,000 would be required to file basic identifying information only.*
- 3) **Leverage existing information outlets to better educate charities regarding ongoing compliance obligations.** *The ACT recommends that EO leverage a range of existing information sources, both within and outside EO, to provide additional information to charities through the initial determination letter, EO website, and partnering with various umbrella organizations.*
- 4) **Eliminate Form 8734.** *The ACT restates its 2003 recommendation that*

*use of Form 8734 at the end of the advance ruling period for publicly supported organizations be eliminated. In the interim, until this can be accomplished, the responsibility for generating and mailing the Form 8734 should be reassigned to the Ogden Service Center.*

- 5) Encourage consideration of donor-advised funds, fiscal sponsorships and other alternatives in lieu of free-standing exemption for smaller organizations.** *The ACT recommends that EO take a more proactive role in promoting education regarding alternatives to establishing free-standing exempt organizations, such as establishing a donor-advised fund within an existing charity, fiscal sponsorship under an established umbrella or incubator charity, becoming a chapter or affiliate of an established charity with or without a group ruling, and partnering with an existing charity having similar goals.*
- 6) Improve partnering with other IRS divisions and coordinate the process of reviewing charities within the various newly established units of EO.** *The ACT recommends that EO explore opportunities for partnering with other IRS divisions both to obtain information about charities and to disseminate information to charities. In addition, EO should continue to develop its newly formed compliance units.*
- 7) Share more information with the states.** *The ACT restates its 2004 recommendation supporting amendment of Section 6103 of the Code to permit EO to share information and coordinate enforcement efforts with agencies charged with overseeing and monitoring exempt organizations in their respective states.*
- 8) Suspend exemption under section 501(c)(3) for failure to file Form 990 for three consecutive years.** *The ACT recommends that an organization's exempt status under section 501(c)(3) be suspended on account of its failure to file Form 990 (including the modified Form 990-EZ in Recommendation #2 as well as the Form 990-PF) for three consecutive years.*

## II. BACKGROUND

### OVERVIEW

In recent years there has been an explosion in the number of new exempt organizations, particularly charities. According to statistics maintained by the National Center for Charitable Statistics,<sup>1</sup> over 800,000 charities are now listed on the IRS' Exempt Organizations Business Master File ("EOBMF") – about twice as many as in 1990. A recent article in the Chronicle of Philanthropy<sup>2</sup> points out that studies indicate that as many as half the charities registered in various states may not have applied for recognition of exemption from the IRS. Some are under the \$5,000 threshold for applying for recognition, but many may not be aware of the relevant filing requirements. Therefore, that 800,000 figure may be understated.<sup>3</sup>

The Chronicle of Philanthropy<sup>4</sup> (using data from the EOBMF) also reports that of the more than 800,000 charities whose exemptions have been recognized by the IRS, approximately 420,000 are Form 990 filers (250,000 file Form 990, 103,000 file Form 990-PF and 67,000 file Form 990EZ), and almost 400,000 are non-filers. While some of these 400,000 non-filers presumably have no reporting responsibilities, there is evidence that that many do. According to the 1994 IRS Exempt Organizations Nonfiler Study, "in about 24 percent of the cases the person responsible for maintaining the organization's books and records was unaware of the obligation to file Form 990 once the organization's gross receipts exceeded \$25,000."<sup>5</sup> These non-filers, whether under the gross receipts threshold, otherwise exempt from filing, or simply non-compliant, have no annual contact with the IRS Exempt Organizations Division ("EO").

This lack of annual contact has been raised as a concern by many both within and outside of the sector. The March 2005 Interim Report presented to the Senate Finance Committee by the Panel on the Nonprofit Sector, convened by Independent Sector ("Interim Report"), raises this as an area of potential reform, and recommends that an annual filing mechanism be established for all organizations currently below the threshold for filing Form 990. The Family and Community Protection Act of 2005 ("MORE Act") proposes an annual contact-information filing by organizations falling below the Form 990 filing threshold, as does the January 2005 Joint Committee on Taxation report. The 2005 EO Implementing Guidelines include a compliance project addressing non-filers, indicating that EO itself recognizes this as an area of concern. Other exempt organization compliance concerns have been addressed by the Government

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<sup>1</sup> National Center for Charitable Statistics at the Urban Institute data ([www.nccs.urban.org](http://www.nccs.urban.org)).

<sup>2</sup> The Chronicle of Philanthropy, "America's Charity Explosion", Ben Gose, January 5, 2005.

<sup>3</sup> In addition, this figure does not include many churches and other religious organizations that are not required to file with IRS in order to establish recognition of exemption.

<sup>4</sup> The Chronicle of Philanthropy, "America's Charity Explosion", Ben Gose, January 5, 2005.

<sup>5</sup> Exempt Organizations Nonfiler Study Report of Findings, December 1994.

Accountability Office (“GAO”),<sup>6</sup> whose April 2002 report focused on EO’s oversight of charities, among other issues. In addition, the Treasury Inspector General for Tax Administration (“TIGTA”)<sup>7</sup> issued a report addressing concerns about the reliability of the EOBFM in December 2000. The report suggested that EO create mechanisms for establishing more frequent contact with organizations and better maintaining current data, including postcard-type updates or other informal methods of contact. In testimony before the Senate Finance Committee (April 2005), Mark Everson, IRS Commissioner, acknowledged difficulties tracking charities due to errors within the EOBFM.

### **TRANSITIONS FACED BY NEWLY-CREATED CHARITIES**

The linchpin of the EO determinations process is the Form 1023, the application required to be filed by the vast majority of organizations seeking recognition of exemption under section 501(c)(3) of the Internal Revenue Code (“Code”). The Form 1023 application provides EO its initial opportunity to review the purposes, governance, planned activities, and sources of support of applicant organizations, and to weed out unqualified organizations. It also informs applicant organizations of the basic requirements for establishing tax-exempt status. Form 1023 was recently revised to provide a more logical, probing series of questions designed to improve the ability of EO determination specialists to evaluate an applicant’s eligibility for recognition of exemption under section 501(c)(3) of the Code.

The 2003 ACT project revealed that at least half of the organizations seeking exemption under IRS section 501(c)(3) of the Code are not represented by professional advisors (lawyers or accountants).<sup>8</sup> Even organizations that retain professional advisors to prepare their exemption applications are not likely to retain such advisors on an ongoing basis. This is particularly likely to be true for volunteer-based organizations.

Once an exempt organization receives the determination letter recognizing it as exempt under section 501(c)(3) of the Code and classifying it as a public charity, it can expect only minimal contact with EO.<sup>9</sup> The Ogden Service Center mails a computer-generated notice (CP-140) entitled “Do You Need to File Form 990?” every three years to the organization’s most recent contact address in the

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<sup>6</sup> “Improvements Possible in Public, IRS, and State Oversight of Charities” (GAO – 02-526), April 2002.

<sup>7</sup> “The Reliability of the Information on the Exempt Organizations Business Master File Needs to Be Improved” (TIGTA, 2001-10-023), December 2000.

<sup>8</sup> “Project ASPIRE: EO Determinations Process Review” – Report of the Advisory Committee on Tax Exempt and Government Entities (May 21, 2003), p. I-10.

<sup>9</sup> Currently, the section 501(c)(3) determination letter is accompanied by an attachment containing a brief discussion of basic compliance issues, including Form 990 filing requirements, UBIT, public inspection, substantiation of contributions, grants to individuals, and public charity status (see Appendix 1). The usefulness of this attachment has not been measured.



EOBMF.<sup>10</sup> Although EO does not track the response rate, it is understood to be low. Approximately one-third of the CP-140 notices are returned as undeliverable. Organizations that have moved within the three-year period are frequently lost by the EOBMF system.<sup>11</sup> Organizations with annual gross receipts normally more than \$25,000 are required to file Form 990 annually, but with the annual examination rate below 1%, follow up contact by EO is not common. The Form 990 is a complex, technical form often falling in the bailiwick of specialized accountants. Professional advisors working with exempt organizations on a pro bono basis may not have knowledge of or experience with the Form 990.

Newly-created organizations that claim public charity status under either of the public support tests of section 509(a)(1) or 509(a)(2) and receive an advance ruling of such status will be asked to complete Form 8734 (soliciting information on actual sources of support) at the end of their 5-year advance ruling period, if EO can find them.

The years immediately following recognition of exemption are crucial to an organization's understanding and development of good compliance habits. Yet it is during these years when EO is likely to lose track of new organizations, making later contact difficult, if not impossible. During the early developmental years, new charities are likely to face a series of transitions, each of which presents its own compliance challenges. Typical transitions include the following:

<u>Transition</u>	<u>Compliance Issues</u>
From founder to new leadership	Governance structures and continuity of mission Intermediate sanctions Related-party transactions and conflicts of interest
From all volunteers to paid staff	Employment taxes and proper reporting Compensation and benefits limitations Employee/Independent Contractor classification
Expanded fundraising efforts	Substantiation and disclosure requirements State registration requirements (fundraisers, games of chance, etc.) Noncash contributions

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<sup>10</sup> IRS does not formally track Notice CP-140, but there is substantial evidence that a significant number do not reach intended recipients or receive a response. Form CP-140 requests basic financial information for the purpose of inquiring into organizations' exempt status and filing requirements. There are no penalties for failure to respond.

<sup>11</sup> Since the U.S. Postal Service does not forward mail after six months, a high return rate for the CP-140 is not unexpected.

New sources of support	Impact on public charity status UBIT liability and reporting \$25,000 threshold for Form 990 filing
From program activity to grantmaking	Criteria and documentation Special rules for foreign grantmaking
From program activity to advocacy	Lobbying limitations Section 501(h) election Political activity prohibition Section 527 rules and reporting
Termination of activities	Notification requirements Dissolution of organization Limitations on distribution of assets

The ACT believes that the vast majority of charities want to comply with the requirements of their exempt status. Unfortunately, despite significant educational and outreach efforts by EO, many lack the information necessary to do so. Each of the transitions noted above can provide a “teaching moment”, an opportunity to guide the new exempt organization along the path of compliance. Too often, however, newly-formed charities pass through these transitions with insufficient guidance. Ill-informed charities, no matter how well intentioned, are more likely to fall into patterns of noncompliance and are at increased risk of manipulation by unscrupulous persons and promoters. At the same time, employees in the sector may be more focused on mission than on such matters as internal functioning. As one report noted:

People do not typically seek careers in the nonprofit sector, or take positions on nonprofit boards, primarily because they want to build organizations with strong infrastructures (accounting, fundraising, information technology, human resources, physical plant, and other common organization elements that support the organization’s mission and program). Rather, people get involved because they are passionate about the mission. However, organizational infrastructure is important for organizational and mission effectiveness.<sup>12</sup>

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<sup>12</sup> Nonprofit Overhead Cost Project, Center on Nonprofits and Philanthropy, Urban Institute, Brief No. 3, Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness (August 2004), p. 3.

## **PREVIOUS PROJECTS**

The ACT has previously published three sets of recommendations designed to assist EO in its administration of the exempt organizations sector. In 2002, the ACT recommended that, because of the increased prominence of the Internet as an inexpensive information source, the EO website include a simple user-friendly “subway map” graphic -- Life Cycle of a Public Charity -- with appropriate links to information and forms relating to significant events in the “life” of a public charity, from formation to dissolution. From the time the Life Cycle of a Public Charity was posted on EO’s website in August 2004 through January 2005, the Life Cycle of a Public Charity has received almost 63,000 hits (an average of 10,440 per month) and almost 100,000 “page visits”.

In 2003, the ACT undertook a comprehensive review of the EO determinations process and recommended a range of alternatives for reforming or replacing that process. By its nature, the 2003 project focused primarily on the formation and earliest operational stages of tax-exempt organizations.

In 2004, the ACT made a series of compliance-related recommendations, including improvement of EO case selection criteria, increased publicity regarding EO compliance initiatives, and enhanced enforcement efforts.

Many of these recommendations, including the Life Cycle of a Public Charity and revision of Form 1023, have been implemented successfully by EO, but more needs to be done, particularly with respect to the needs of and particular compliance concerns presented by smaller, newly-created exempt organizations.<sup>13</sup>

### **III. PROJECT FOCUS**

Project IMPROVE seeks to address the interactions necessary between EO and newly-created Code section 501(c)(3) public charities (“charities”) during the crucial post-exemption stage. Building on earlier ACT reports and recommendations, Project IMPROVE will recommend a range of alternatives to assist EO in tracking newly-formed charities, in communicating with these charities, and in enhancing compliance levels by addressing the common transitions encountered by charities in their developmental years. Implementation of these recommendations will enhance EO oversight of newly-created charities and will increase the likelihood that these organizations will mature into compliant and productive members of the exempt organizations sector.

### **IV. PROJECT PROCESS**

The Project Group obtained information and statistics about tax compliance of small charities in the early stages of organizational development

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<sup>13</sup> Statistics show that 64% of all Code section 501(c)(3) organizations operate with annual budgets under \$500,000. Interim Report at page 9.

through a series of interviews with staff from EO and individuals in the private sector, and from a review of public and private reports and studies.

From interviews with EO staff, the Project Group sought to obtain a detailed understanding of processes in the IRS that might affect these charities. Our interviews covered operation of the EO Call Center; the determinations process; processes for attempting to locate exempt organizations with outdated contact information; the process for sending out Form 8734 at the end of an organization's advance ruling period; the creation, maintenance and updating of the EOBFM; the returns processing function; the examinations function; and the education and outreach function. The Project Group also sought to understand the interaction among geographically dispersed EO functions. The determinations function and the Call Center are located in Cincinnati, Ohio; the examinations function is headquartered in Dallas, Texas; the returns processing function is located in Ogden, Utah; and, the TE/GE Division headquarters is located in Washington, D.C.

The Project Group interviewed the following TE/GE staff: Sarah Hall Ingram, Deputy Commissioner TE/GE Division, Martha Sullivan, Director, Exempt Organizations; Roberta Zarin, Director, Customer Education & Outreach; Lois Lerner, Director, EO Rulings and Agreements; Marvin R. Friedlander, Manager, Technical, EO Rulings and Agreements; Jack Reilly, Assistant to Senior Technical Advisor to the Commissioner; Janna Skufka, Director, Customer Account Services; Cindy Westcott, EO Manager, Determinations, Rulings and Agreements; Midori Morgan-Gaide, Manager, EO Electronic Initiatives; Rosie Johnson, Director, EO Examinations; Ron Williams, Project Manager, Business Systems Planning; Dave Fish, Manager, Group 2 Technical Guidance & Quality Assurance; Joseph J. Urbin, Manager Technical Guidance & Quality Assurance; Steve Machhio, Manager, Processing Center Programs; and Leonard Henzke, Jr., Senior Tax Law Specialist.

The Project Group asked each individual to explain the existing EO procedures, points of contact, outreach/education programs, and publications aimed at enhancing compliance by exempt organizations, but particularly those designed for newly-created charities. The Project Group also asked each to assess the effectiveness of these current efforts in keeping charities informed of their reporting and filing requirements and to identify how these efforts could be improved both within existing resource constraints and should additional resources become available.

Individual members of the Project Group interviewed two state charities officials, Karl Emerson, Director, Pennsylvania Bureau of Charitable Organizations, and James Siegal, Assistant Attorney General, New York State Charities Bureau, to obtain their views on the most important compliance issues for small organizations in the early years of operation, relevant initiatives by the states, and ways in which the states and the IRS could work together to improve education and compliance. The Project Group also sought the views of professionals in the private sector who have a particular interest in small and emerging exempt organizations. We asked them about recurring problems,

areas of common misunderstanding, and solicited their suggestions for improvement. The Project Group interviewed Sean Delany, Executive Director, and Elizabeth M. Guggenheimer, Legal Director, Lawyers Alliance for New York (“LANY”), an organization that assists 450 community-based non-profits in New York; Allen Bromberger, at that time President, Power of Attorney, an organization which helps set up organizations like LANY around the country; Jonathan Small, at that time Executive Director, Nonprofit Coordinating Committee of New York, an organization of approximately 1,200 members; Florence Green, Executive Director, California Association of Nonprofits, an organization of approximately 1,700 members; Eve Borenstein, Principal, Borenstein and McVeigh Law Office LLC, Minneapolis, Minnesota; and Jody Blazek, Partner, Blazek & Vettering, Houston, Texas.

Finally, the Project Group interviewed Susan Kenny Stevens, a consultant, lecturer and author with expertise in organizational behavior. She is the author of *Nonprofit Lifecycles: Stage-based Wisdom for Nonprofit Capacity*, a book that discusses the development of nonprofit organizations in terms of seven lifecycle stages.

The Project Group also reviewed and considered the observations and findings of numerous reports, legislative proposals and bills that related to the compliance of small exempt organizations. These included the following IRS reports: National Taxpayer Advocate, 2004 Annual Report to Congress; Improvement Project Plan (“IPP”) (August 2004); EO/BMF Study: Improving Data Quality (January 2002); TIGTA Report No. 2004-10-177, EO Procedures and EO Returns (September 2004); and TIGTA Report No. 2001-10-023, The Reliability of the Information on the EO/BMF Needs to be Improved (December 2000); and Exempt Organizations Nonfiler Study (December 1994). The Project Group also reviewed GAO Report No. GAO-02-526 (April 2002), Improvements Possible in Public, IRS, and State Oversight of Charities and GAO Report No. GAO-05-5617 (April 2005), Tax-Exempt Sector Governance, Transparency and Oversight are Critical for Maintaining Public Trust. As the Project Group’s work took place concurrently with legislative developments, the Group reviewed S. 6, The Family and Community Protection Act of 2005 (MORE Act); the Joint Committee Staff Report, JCS-02-05, Options to Improve Tax Compliance and Reform Tax Expenditures (January 2005); the Interim Report presented to the Senate Finance Committee by the Panel on the Nonprofit Sector convened by Independent Sector (March 2005), and the Joint Committee Staff Report, JCS-29-05, Historical Development and Present Law of the Federal Tax Exemption for Charities and Other Tax-Exempt Organizations (April 2005).

## **V. RECOMMENDATIONS**

**1) Enhance the quantity and quality of EO contacts with charities.** *The ACT recommends that EO pursue a range of opportunities to increase the number of contacts with charities and improve the quality of those contacts. The following opportunities would assist EO in locating charities and informing them of their compliance obligations on an ongoing basis. The ACT encourages EO to*

explore other creative opportunities to interact with charities, particularly during key transition periods.

**a. Require additional contact information on Form 1023 and Form 990.**<sup>14</sup> *The ACT recommends that Form 1023 and Form 990 require organizations to provide e-mail addresses and secondary contact information in order to increase the likelihood that EO will be able to locate and contact them for education and compliance purposes.*<sup>15</sup> *EO should send charities, for which e-mail addresses are included in the EO BMF, information on registering for EO Update, upcoming EO workshops, and other relevant compliance information.*<sup>16</sup>

Background. Form 1023 currently requests that an applicant organization identify a primary contact (officer, director, trustee or authorized representative). Experience shows that there is relatively high turnover among these individuals. Form 1023 also requires the URL for a charity's website, if any. Provision of the charity's e-mail address is optional. Form 990 currently requests that a charity provide the URL for its website, if any. Anecdotally, the ACT believes that many charities do not have a website at the time they file Form 1023 but subsequently develop one and fail to report it on Form 990.

**b. Enhance EO Call Center message options.** *The ACT recommends that EO add "while you wait" Call Center messages (or additional options to the Call Center's automated menu) to inform callers of the submission date for which applications for exemption are currently being processed, to refer callers to the Life Cycle of a Public Charity on the EO website, to summarize basic Form 990 filing information, to remind callers that EO may discuss taxpayer information only with authorized representatives,<sup>17</sup> and to provide other commonly-requested generic information. Eliminating the need for callers to speak with an EO representative will enable the Call Center to improve its service rate and devote more attention to calls requiring individualized attention.*

Background. The Call Center is an important source of information for newly-created organizations, particularly those that are not represented by professional advisors. Over 11% of the calls to the EO Call Center are inquiries relating to the exemption application process.<sup>18</sup> A common reason people call is

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<sup>14</sup> Although the focus of this project is public charities, this recommendation has equal relevance to Form 1024 (for non-section 501(c)(3) applicants) and Form 990-PF (for private foundations).

<sup>15</sup> Section 322 of the MORE Act would also require disclosure of an exempt organization's website.

<sup>16</sup> Section 335 of the MORE Act would clarify the definition of the church tax inquiry under section 7611 to permit IRS to provide information regarding the standards for exemption under section 501(c)(3) and UBIT without triggering the church tax inquiry provisions of section 7611, and would permit EO educational outreach to churches.

<sup>17</sup> EO should include a caveat relating to authorized representatives in all information regarding the Call Center that it disseminates.

<sup>18</sup> National Taxpayer Advocate 2004 Annual Report to Congress, page 195.

to ascertain the status of their organizations' applications. If that information were provided in a frequently updated "while-you-wait" message, many callers might not need to speak with an EO representative. The Call Center currently responds to only half of its calls,<sup>19</sup> and does not inform callers about delays in processing exemption applications. Although EO can respond to any generic questions, it may discuss specific taxpayer information only with a charity's authorized representatives.

**c. Expand FAQs on EO website.** *The ACT recommends that EO expand significantly the Frequently Asked Questions ("FAQs") regarding "Operating as an Exempt Organization" on the EO website to deal with a range of operational questions presented by various common transitions in the life of a charity. The new FAQs might cover topics such as:*

- What should I do now that my charity has paid employees?*
- What should I do now that my charity has started soliciting funds?*
- Will my charity's new sources of support cause any problems?*
- Will my charity's new earned income give rise to an unrelated business income tax liability?*
- What documentation should my charity provide to contributors?*
- What forms does my charity need to file with IRS?*
- My charity has ceased operations. What should I do?*

*Responses to the above FAQs should link to the Life Cycle of a Public Charity whenever appropriate.*

**Background.** Much basic operational information is included in various EO publications. Some topics are covered on the Life Cycle of a Public Charity and in the existing FAQs. However, informational redundancy is a good thing when dealing with charities, particularly those that are not represented by professional advisors. The current operational FAQs are limited to five short discussions: impermissible activities, endorsing candidates, the difference between public charities and private foundations, the meaning of an advance ruling period, and changes in purposes or activities. Additional operational issues should be addressed with appropriate links to the Life Cycle of a Public Charity or other resources on the EO website.

**d. Continue to pursue electronic filing initiatives.** *The ACT recommends that EO continue to pursue electronic filing for Forms 990, 990-PF and Form 1023. This will improve service to taxpayers and enforcement of tax laws by enabling errors, inconsistencies and missing information to be more quickly identified, as well as ultimately result in cost savings for EO due to streamlining access to data and reducing paperwork. It will save time for both charities and EO staff since an incomplete form will be rejected before being submitted, and will aid in the ability to locate newly-created organizations, since the contact information will be enhanced.*

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<sup>19</sup> Of a total call demand of 668,000, 367,000 calls were answered, for a service rate of 54.9 percent. National Taxpayer Advocate 2004 Annual Report to Congress, page 198.

Background. The EO has released temporary regulations requiring “large organizations” to begin e-filing their annual information returns in 2006. EO believes (and we support) that electronic filing will help speed tax processing and reduce audit cycle time, as well as resolve audit uncertainties earlier. As the Interim Report indicated, electronic filing should aid in compliance both with 990 requirements, and Form 1023 applications.

**2) Lower the Form 990 filing threshold to \$5,000. Require charities, not otherwise exempt from the Form 990 filing requirement and having gross receipts between \$5,000 and \$25,000, to complete and submit a modified version of the top section of Form 990-EZ.** *The ACT recommends that the Secretary of the Treasury rescind the discretionary exemption for charities with gross receipts normally below \$25,000 and reinstate the \$5,000 statutory filing threshold. In order to minimize the administrative burden on small charities, organizations with gross receipts normally between \$5,000 and \$25,000 would be required to submit only basic identifying information (name, EIN, address, website address, e-mail address, primary and secondary contact information, certification that gross receipts remain below \$25,000, and, where applicable, notice of termination.<sup>20</sup>)*

Background. To relieve administrative burdens on small charities, the \$5,000 statutory threshold for filing Form 990 under section 6033(a)(2)(A)(ii) was increased to its current level of \$25,000 under the discretionary authority of the Secretary of the Treasury.<sup>21</sup> An unintended consequence of this discretionary exemption for the Form 990 filing requirement has been that EO has lost contact with a significant percentage of small charities in the years following recognition of exemption. The 1994 Exempt Organizations’ Nonfiler Study estimated that 14% of the nonfilers (below the \$25,000 threshold) had terminated their activities, and another 7% could not be located by IRS agents even after exhaustive searches.<sup>22</sup> Imposing a modified annual filing requirement on virtually all charities<sup>23</sup> would enable EO to update the EOBFM with current contact information and permit deletion of terminated organizations. In addition, this modified annual filing requirement would require most organizations to file Form 990 from the outset, thus increasing the likelihood that small organizations will comply with their full Form 990 filing obligations when they reach the \$25,000 threshold.

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<sup>20</sup> Similar recommendations are contained in Section 327 of the MORE Act, the Senate Finance Committee’s 2004 Staff Discussion Draft, and the Panel on the Nonprofit Sector’s March 1, 2005 Interim Report presented to the Senate Finance Committee.

<sup>21</sup> Rev. Proc. 83-23, 1983-1 C.B. 687.

<sup>22</sup> E-mails from Marv Friedlander and Ron Williams dated March 3, 2005, and referring to the 1994 EO Nonfiler Study. We understand that the “lost” exempt organization phenomenon is not an issue with private foundations. Small private foundations, which are required to file Form 990-PF annually regardless of revenue, rarely fall off EO’s radar screen, thereby validating the annual-filing approach.

<sup>23</sup> A \$5,000 Form 990 filing threshold would align with the general Form 1023 filing threshold under section 508(c)(1)(B).



Comment. Requiring many more organizations to file even a modified annual return can be expected to increase the workload at the Ogden Service Center, at least in the short term. However, offsetting efficiencies can be expected from an EOBFM with significantly more accurate information and with the expansion of electronic filing of Form 990 generally. For example, it should no longer be necessary to mail CP-140, and when Form 8734 is mailed, fewer forms should be returned as undeliverable.<sup>24</sup> Current efforts to research the whereabouts of lost charities could be eliminated.

**3) Leverage existing information outlets to better educate charities regarding ongoing compliance obligations.** *The ACT recommends that EO leverage a range of existing information sources, both within and outside EO, to provide additional information to charities. The below outlets have been identified as likely avenues for enhancing compliance, particularly among small charities that are not represented by professional advisors.*

Background. EO currently maintains a number of outlets for providing information to exempt organizations, including the EO website, the Call Center, various publications and educational workshops and forums. While each of these outlets is an important source of information, additional steps can be taken to maximize their reach and usefulness within the exempt organizations community. Such efforts can significantly benefit small, newly-created charities, which are unlikely to be represented by professional advisors.

**a. Initial Determination Letter.** *The ACT recommends that information sent to a charity with its initial determination letter include information on: the location of the Life Cycle of a Public Charity and FAQs on the EO website; registering for EO Update; and the Call Center (including an admonition regarding authorized representatives, if any). The ACT also recommends that the explanatory memorandum currently enclosed with the initial determination letter be revised to be more visually appealing and user friendly to enhance the likelihood it will be read, retained, and referred to by newly-created charities. Further, when EO sends out a replacement determination letter, a confirmation of exempt status, or a public charity classification letter, it should include another copy of the explanatory memorandum.*

**b. EO Website.** *The ACT recommends that the following additional information be included on the EO website:*

*-- Form 1023 application update to inform applicant organizations of the submission date for which applications for exemption are currently being processed.*

*-- links to information on various EO workshops, particularly those held in partnership with states or professional organizations, as well as programs conducted through state charities officials, state nonprofit councils, Independent Sector, Council on Foundations, Better Business Bureau, and other umbrella groups.*

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<sup>24</sup> See also Recommendation 4 to eliminate Form 8734.

**c. Partnering with Umbrella Organizations.** *The ACT recommends that EO increase its presence within the exempt organizations sector through partnered workshops with umbrella groups such as the American Bar Association, American Institute of Certified Public Accountants, American Society of Association Executives, National Association of State Charity Officials, National Association of College and University Business Officers, state bar associations and state councils of nonprofits, and seek the assistance of these groups to publicize EO workshops, publications and other resources.*

**4) Eliminate Form 8734.** *The ACT restates the 2003 ACT recommendation<sup>25</sup> that use of Form 8734 at the end of the advance ruling period for publicly supported organizations be eliminated. Instead, the final determination of public support should be made on the basis of Schedule A to Form 990, which might be amended to contain 5 years' financial data. In the interim, until the elimination of Form 8734 can be implemented, the ACT recommends that the responsibility for generating and mailing the Form 8734 at the end of the advance ruling period on the basis of current contact information in the EOBF be reassigned to the Ogden Service Center.*

Background: Form 8734 must be completed at the end of the 5-year advance ruling period by newly-created organizations that claim public charity status under either the public support test of section 509(a)(1) or 509(a)(2) and receive an advance ruling of such status. The advance ruling period and Form 8734 are a source of confusion for charities, particularly smaller organizations not represented by professional advisors, many of which erroneously believe that Form 8734 requires them to re-establish exempt status. The actual sources and amounts of support of many charities deviate significantly from the sources and amounts of support estimated on their Forms 1023. In addition, the financial information requested on Form 8734 differs from the financial information required on Schedule A of Form 990.

Under current procedures, when an EO determinations case is closed in the Cincinnati Office, relevant information regarding the organization is entered into EDS (Exempt Determinations System), from which the information is transmitted to the EOBF and ultimately to Publication 78. The EOBF includes a field showing the expiration date of a charity's advance ruling period and contains the most current contact information, which may have been updated on the basis of contacts with the charity subsequent to its determination of exempt status. Currently, administrative staff in the Cincinnati Office are responsible for generating and mailing the Form 8734 on the basis of information contained in the EOBF and manually researching (through phone books, the Internet, etc.) the significant percentage of Forms 8734 that are returned as undeliverable.

Comment: A definitive ruling of public charity status or private foundation status could be made automatically at the end of the 5-year advance ruling period on the basis of the financial information provided on a charity's annual

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<sup>25</sup> "Project ASPIRE: EO Determinations Process Review" – Report of the Advisory Committee on Tax Exempt and Government Entities (May 21, 2003), p. I-14-15.

Form 990. Issuance of the definitive ruling on the basis of this automatic computation would be the responsibility of the Ogden Service Center. Thereafter, review of the charity's public support percentage could be made automatically by the Ogden Service Center on the basis of information provided on the Form 990. The Ogden Service Center would be responsible for notifying charities of any change in status.

At a minimum, capturing Form 990 financial information for charities coded under section 509(a)(1) or 509(a)(2) would be required before automatic computation of public support could be implemented. In addition, elimination of Form 8734 would mean that small charities (below the \$25,000 threshold for reporting financial information on Form 990) and any other charities that are not required to file Form 990, e.g., certain integrated auxiliaries of a church, could not be tracked for compliance.

Until electronic capturing of Form 990 financial data progresses to a degree that permits elimination of Form 8734, generation and mailing of Form 8734 should be the responsibility of the IRS function best qualified to undertake the task, namely, the Ogden Service Center. The Ogden Service Center maintains the EOBF, which includes the advance ruling expiration date and the most current contact information. The number of forms that are returned as undeliverable will be greatly reduced if charities with gross receipts above \$5,000 are required to submit updated contact information every year. The Ogden Service Center should have responsibility for generating Form 8734 even if the form must be returned to Cincinnati for review and evaluation.

**5) Encourage use of donor-advised funds, fiscal sponsorships and other alternatives in lieu of free-standing exemption for smaller organizations.**

*The ACT recommends that EO take a more proactive role in educating small organizations about alternatives to establishing free-standing exempt organizations, such as establishing a donor-advised fund within an existing charity, fiscal sponsorship under an established umbrella or incubator charity, becoming a chapter or affiliate of an established charity with or without a group ruling, and partnering with an existing charity having similar goals. While we do not believe that EO should make specific recommendations regarding which applicants might be better-off not forming free-standing organizations or steer them toward particular established organizations, it would be helpful for EO to provide general information on alternatives to forming a new charity. EO can provide education on the alternatives through the following means:*

*-- Challenge organizations to consider whether free-standing exemption is the appropriate choice in the instructions to Form 1023, including a "suitability checklist." For example, if the purpose of the organization is to accept tax-deductible contributions following the death of a family member, consider whether a gift to a donor-advised fund (with family serving as the advisors) or a gift to a restricted fund within an existing charity would be a faster and more cost-effective choice.*

*-- Pose the question regarding the appropriateness of free-standing exemption and the alternatives thereto in IRS publications, including Publication 1771 (charitable contributions) and Publication 3833 (disaster relief).*

*-- Include a "suitability checklist" that challenges the appropriateness of free-standing exemption as part of the "Getting Started" option on the Life Cycle of a Public Charity and in the "Applying for Tax Exemption" section of the EO FAQs.*

*-- Include discussions of the appropriateness of free-standing exemption and the alternatives thereto in EO workshops and forums dealing with basic exemption issues.*

*-- Develop a new resource which presents a continuum of options for achieving charitable objectives.*

*Background.* Most individuals who are passionate about a particular charitable cause are not aware of the various alternatives to creating an organization and filing for recognition of exemption under section 501(c)(3) status, with the numerous compliance obligations flowing from that status, not the least of which are the Form 990 filing requirement and the responsibility of maintaining proper levels of public support. Many exempt organizations established in this manner, without a solid business plan or clear mission statement, simply "wither on the vine" without ever being properly dissolved, filing final Forms 990, or otherwise notifying EO that they are no longer operating. This short life cycle is particularly noticeable for organizations created in the wake of any major disaster. A great deal of time and effort is expended by such organizations and EO when alternatives to free-standing exemption would better realize their founders' goals with significantly reduced administrative burdens. In addition, higher levels of compliance can be expected if charitable activities are conducted under the aegis of established charities.

**6) Improve partnering with other IRS divisions and coordinate the process of reviewing charities within the various newly established units of EO.**

*The ACT recommends that EO explore opportunities for partnering with other IRS divisions both to obtain information about charities and to disseminate information to charities. In addition, the ACT supports the increased enforcement to be provided by EO's two new units; the EO Compliance Unit, designed to review Form 990s and correspond with organizations regarding inconsistencies, errors and other matters not necessarily requiring an examination, including non-filers of Form 990, and the Data Analysis Unit, which will use data to better select cases for examination. In addition, EO is in the process of organizing its Financial Investigations Unit, which will be used to investigate those cases involving fraud and terrorism. EO is also in the early stages of setting up a new group that will identify and follow up with selected form 990 filers in the first years of their operations to compare the Form 1023 disclosure of potential operations with their actual activities.*

Background. Other divisions of IRS interact with charities. For example, charities with employees are required to file Form 941, Employers' Quarterly Federal Tax Return, with the Wage and Hour Division. Coordination between the two divisions could result in sharing of payroll information, which would assist EO in determining whether a nonfiler charity has exceeded the \$25,000 Form 990 filing threshold. EO may be able to disseminate basic compliance information, e.g., Form 990 filing requirements, to small charities with their Form 941 filing packages, and seek a link to the Form 990 filing requirements for charities through the Wage and Hour website. In addition EO has recently established new compliance units within EO to better track data regarding charities. As it is too soon to tell how effective this is, we recommend that EO continue to devote efforts to establishing these units.

**7) Share more information with the states.** *The ACT restates the 2004 ACT recommendation<sup>26</sup> supporting amendment of Section 6103 of the Code to permit EO to share information and coordinate enforcement efforts with agencies charged with overseeing and monitoring exempt organizations in their respective states. The ACT also recommends that EO request that states share information regarding the dissolution of nonprofit corporations so that they can be deleted from the EOBFM.*

Background. The 2004 ACT recommendations, the Senate Finance Committee Staff Discussion Draft, the Interim Report, and the MORE Act are in accord with respect to the necessity of better coordination and sharing of information between EO and the states, and thus the necessity for amending Code Section 6013. Amendment of Code Section 6103 has been the number one strategic planning goal of NASCO for many years. Information sharing between EO and the states will become easier with the expansion of electronic filing.

**8) Suspend exemption under Code section 501(c)(3) for failure to file Form 990 for three consecutive years.** *The ACT recommends that an organization's exempt status under Code section 501(c)(3) be suspended on account of its failure to file Form 990 (including the modified Form 990-EZ in Recommendation #2 or the Form 990-PF) for three consecutive years. Suspended organizations should be notified of their suspension. They would not be eligible to receive deductible contributions, and would be removed from the EOBFM and Publication 78. The ACT recommends that EO develop an abbreviated process (short of filing a new Form 1023) for suspended organizations to re-establish exempt status. Suspension for failure to file Form 990 should not trigger declaratory judgment rights under section 7428.*

Background. The EOBFM is populated with numerous nonfiler organizations, either because they are inactive, dissolved, or merely non-compliant. Currently, EO has no clear process for dealing with these nonfiler organizations or removing them from the EOBFM. The Senate Finance

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<sup>26</sup> "Ripple Project – Recommendations to Enhance EO Enforcement and Compliance Efforts", Report of the Advisory Committee on Tax Exempt and Government Entities (June 9, 2004), p. V-22.

Committee's Staff Discussion Draft, the Interim Report, and the MORE Act have offered various proposals for dealing with nonfiler organizations, recommending either revocation or suspension after two or three consecutive years of nonfiling. Currently, "suspension" is a term of art limited to Code section 501(p) as applied to designated terrorist organizations. Suspension under section 501(p) is automatic. EO makes no substantive determination of eligibility for exemption, and there is no process for reapplying to IRS to reinstate exemption.

"Revocation" is a substantive determination by EO that an organization is no longer qualified for exemption. It triggers declaratory judgment rights under section 7428, including court challenges to the IRS determination. An organization whose status is revoked and does not prevail in a declaratory judgment action must submit a new Form 1023 to establish that it has corrected the defect that led to its revocation.

*Comment.* Implementation of this recommendation would likely require legislative action.

**Internal Revenue Service**

Director, Exempt Organizations Rulings & Agreements  
P.O. Box 2508  
Cincinnati OH 45202

**Department of the Treasury**

Date:

Name of Organization  
Address

Employer Identification Number:

Person to Contact and ID Number

Toll Free Contact Number:  
(877) 829-5500

Accounting Period Ending:

Public Charity Status:

Form 990 Required:

Effective Date of Exemption:

Contribution Deductibility:

Dear Applicant:

We are pleased to inform you that upon review of your application for tax exempt status we have determined that you are exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code. Contributions to you are deductible under section 170 of the Code. You are also qualified to receive tax deductible bequests, devises, transfers or gifts under section 2055, 2106 or 2522 of the Code. **Because this letter could help resolve any questions regarding your exempt status, you should keep it in your permanent records.**

Organizations exempt under section 501(c)(3) of the Code are further classified as either public charities or private foundations. We determined that you are a public charity under the Code section(s) listed in the heading of this letter.

Please see enclosed *Information for Organizations Exempt Under Section 501(c)(3)* for some helpful information about your responsibilities as an exempt organization.

**"ADDENDUM" TEXT WILL BE INSERTED IN BODY OF LETTER. -- USE SELECTIVE PARAGRAPHS 1 – 7 ON ATTACHMENT.**

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations  
Rulings & Agreements

Enclosure: *Information for Organizations Exempt Under Section 501(c)(3)*

Selective paragraphs:

1. This exemption letter is based on the understanding you will enter into a formal agreement with the state regulatory agency to operate as a provider under the Special Nutrition Food Program and will operate that program within the state's guidelines.
2. Please keep records on the training given to child care providers, the number of inspections, reports submitted to the state, and financial records showing your receipts and expenditures.
3. If you distribute funds to other organizations, your records must show whether they are exempt under section 501(c)(3). In cases where the recipient organization is not exempt under section 501(c)(3), you must have evidence the funds will be used for section 501(c)(3) purposes.
4. If you distribute funds to individuals, you should keep case histories showing the recipient's name and address; the purpose of the award; the manner of selection; and the relationship of the recipient to any of your officers, directors, trustees, members, or major contributors.
5. Information submitted with your application indicates you may engage in lobbying activities. Section 501(c)(3) of the Code specifically prohibits lobbying as a substantial part of your activities. If you do not wish to be subject to the test of substantiality under section 501(c)(3), you may elect to be covered under the provisions of section 501(h) of the Code by filing Form 5768, *Election/Revocation of Election by an Eligible Section 501(c)(3) Organization to Make Expenditures to Influence Legislation*. Section 501(h) establishes ceiling amounts for lobbying expenditures.
6. If you are a wholly-owned instrumentality of a state or political subdivision of a state, wages paid for services performed for you are not subject to unemployment taxes under the Federal Unemployment Tax Act (FUTA). Wages may be subject to social security taxes under the Federal Insurance Contributions Act (FICA) if a section 218 agreement with the Social Security Administration covers the positions. Consult with your State Social Security Administrator to determine if your organization is responsible for FICA coverage. All employees hired after March 31, 1986, are subject to mandatory Medicare coverage.
7. Revenue Procedure 75-50, published in Cumulative Bulletin 1975-2 on page 578, sets forth guidelines and record keeping requirements for determining whether private schools have racially nondiscriminatory policies as to students. You must comply with this revenue procedure to maintain your tax exempt status.



# Information for Organizations Exempt Under Section 501(c)(3)

## WHERE TO GET FORMS AND HELP

Forms and instructions may be obtained by calling **toll free 1-800-829-3676**, through the Internet Web Site at [www.irs.gov](http://www.irs.gov), and also at local tax assistance centers.

Additional information about any topic discussed below may be obtained through our customer service function by calling **toll free 1-877-829-5500** between 8:00 a.m. - 6:30 p.m. Eastern time.

## NOTIFY US ON THESE MATTERS

If you change your name, address, purposes, operations or sources of financial support, please inform our TE/GE Customer Account Services Office at the following address: Internal Revenue Service, P.O. Box 2508, Cincinnati, Ohio 45201. If you amend your organizational document or by-laws, or dissolve your organization, provide the Customer Account Services Office with a copy of the amended documents. Please use your employer identification number on all returns you file and in all correspondence with the Internal Revenue Service.

## FILING REQUIREMENTS

In your exemption letter we indicated whether you must file Form 990, *Return of Organization Exempt From Income Tax*. Form 990 (or Form 990-EZ) is filed with the Ogden Submission Processing Center, Ogden UT 84201-0027.

You are required to file a Form 990 only if your gross receipts are normally more than \$25,000.

If your gross receipts are normally between \$25,000 and \$100,000, and your total assets are less than \$250,000, you may file Form 990-EZ. If your gross receipts are over \$100,000, or your total assets are over \$250,000, you must file the complete Form 990. The Form 990 instructions show how to compute your "normal" receipts.

Form 990 Schedule A is required for both Form 990 and Form 990-EZ.

If a return is required, it must be filed by the 15th day of the fifth month after the end of your annual accounting period. There are penalties for failing to timely file a complete return. For additional information on penalties see the Form 990 instructions or call our toll free number.

If your receipts are below \$25,000, and we send you a Form 990 Package, follow the instructions in the package on how to complete the limited return to advise us that you are not required to file.

If your exemption letter states that you are not required to file Form 990 you are exempt from these requirements.

## UNRELATED BUSINESS INCOME TAX RETURN

If you receive more than \$1,000 annually in gross receipts from a regular trade or business you may be subject to Unrelated Business Income Tax and required to file Form 990-T, *Exempt Organization Business Income Tax Return*. There are several exceptions to this tax.

1. Income you receive from the performance of your exempt activity is not unrelated business income.
2. Income from fundraisers conducted by volunteer workers, or where donated merchandise is sold, is not unrelated business income.
3. Income from routine investments such as certificates of deposit, savings accounts, or stock dividends is usually not unrelated business income.

There are special rules for income derived from real estate or other investments purchased with borrowed funds. This income is called "debt financed" income. For additional information regarding unrelated business income tax see Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*, or call our toll free number shown above.

## PUBLIC INSPECTION OF APPLICATION AND INFORMATION RETURN

You are required to make your annual information return, Form 990 or Form 990-EZ, available for public inspection for three years after the later of the due date of the return, or the date the return is filed. You are also required to make available for public inspection your exemption application, any supporting documents, and your exemption letter. Copies of these documents are also required to be provided to any individual upon written or in person request without charge other than reasonable fees for copying and postage. You may fulfill this requirement by placing these documents on the Internet. Penalties may be imposed for failure to comply with these requirements. Additional information is available in Publication 557, *Tax-Exempt Status for Your Organization*, or you may call our toll free number shown above.

## FUNDRAISING

Contributions to you are deductible only to the extent that they are gifts and no consideration is received in return. Depending on the circumstances, ticket purchases and similar payments in conjunction with fund-raising events may not qualify as fully deductible contributions.

### Contributions of \$250 or more

Donors must have written substantiation from the charity for any charitable contribution of \$250 or more. Although it is the donor's responsibility to obtain written substantiation from the charity, you can assist donors by providing a written statement listing any cash contribution or describing any donated property.

This written statement must be provided at the time of the contribution. There is no prescribed format for the written statement. Letters, postcards and electronic (e-mail) or computer-generated forms are acceptable.

The donor is responsible for the valuation of donated property. However, your written statement must provide a sufficient description to support the donor's contribution. For additional

information regarding donor substantiation, see Publication 1771, *Charitable Contributions - Substantiation and Disclosure Requirements*. For information about the valuation of donated property see Publication 561, *Determining the Value of Donated Property*.

### **Contributions of more than \$75 and Charity Provides Goods or Services**

You must provide a written disclosure statement to donors who receive goods or services from you in exchange for contributions in excess of \$75.

Contribution deductions are allowable to donors only to the extent their contributions exceed the value of the goods or services received in exchange. Ticket purchases and similar payments in conjunction with fund-raising events may not necessarily qualify as fully deductible contributions, depending on the circumstances. If your organization conducts fund-raising events such as benefit dinners, shows, membership drives, etc., where something of value is received, you are required to provide a written statement informing donors of the fair market value of the specific items or services you provided in exchange for contributions of more than \$75.

You should provide the written disclosure statement in advance of any event, determine the fair market value of any benefit received, determine the amount of the contribution that is deductible, and state this information in your fund-raising materials such as solicitations, tickets, and receipts. The amount of the contribution that is deductible is limited to the excess of any money (and the value of any property other than money) contributed by the donor less the value of goods or services provided by the charity. Your disclosure statement should be made, no later than, at the time payment is received. Subject to certain exceptions, your disclosure responsibility applies to any fund-raising circumstance where each complete payment, including the contribution portion, exceeds \$75. For additional information, see Publication 1771 and Publication 526, *Charitable Contributions*.

### **EXCESS BENEFIT TRANSACTIONS**

Excess benefit transactions are governed by section 4958 of the Code. Excess benefit transactions involve situations where a section 501(c)(3) organization provides an unreasonable benefit to a person who is in a position to exercise substantial influence over the organization's affairs. If you believe there may be an excess benefit transaction involving your organization, you should report the transaction on Form 990 or 990-EZ. Additional information can be found in the instructions for Form 990 and Form 990 EZ, or you may call our toll free number to obtain additional information on how to correct and report this transaction.

### **EMPLOYMENT TAXES**

If you have employees, you are subject to income tax withholding and the social security taxes imposed under the Federal Insurance Contribution Act (FICA). You are required to withhold federal income tax from your employee's wages and you are required to pay FICA on each employee who is paid more than \$100 in wages during a calendar year. To know how much income tax to withhold, you should have a Form W-4, *Employee's Withholding Allowance Certificate* on file for each employee. Organizations described in section 501(c)(3) of the Code are not required to pay Federal Unemployment Tax (FUTA).

Employment taxes are reported on Form 941, *Employer's Quarterly Federal Tax Return*. The requirements for withholding, depositing, reporting and paying employment taxes are explained

in Circular E, *Employer's Tax Guide*, (Publication 15), and *Employer's Supplemental Tax Guide*, (Publication 15-A). These publications explain your tax responsibilities as an employer.

## CHURCHES

Churches may employ both ministers and church workers. Employees of churches or church-controlled organizations are subject to income tax withholding, but may be exempt from FICA taxes. Churches are not required to pay FUTA tax. In addition, although ministers are generally common law employees, they are not treated as employees for employment tax purposes. These special employment tax rules for members of the clergy and religious workers are explained in Publication 517, *Social Security and Other Information for Members of the Clergy and Religious Workers*. Churches should also consult Publications 15 and 15-A.

## PUBLIC CHARITY STATUS

Every organization that qualifies for tax exemption as an organization described in section 501(c)(3) is a private foundation unless it falls into one of the categories specifically excluded from the definition of that term (referred to in section 509(a)(1), (2), (3), or (4)). In effect, the definition divides these organizations into two classes, namely **private foundations** and **public charities**.

Public charities are generally those that either have broad public support or actively function in a supporting relationship to those organizations.

Public charities enjoy several advantages over private foundations. There are certain excise taxes that apply to private foundations but not to public charities. A private foundation must also annually file Form 990 PF, *Return of Private Foundation*, even if it had no revenue or expenses.

The Code section under which you are classified as a public charity is shown in the heading of your exemption letter. This determination is based on the information you provided and the request you made on your Form 1023 application. Please refer to Publication 557 for additional information about public charity status.

## GRANTS TO INDIVIDUALS

The following information is provided for organizations that make grants to individuals. If you begin an individual grant program that was not described in your exemption application, please inform us about the program.

Funds you distribute to an individual as a grant must be made on a true charitable basis in furtherance of the purposes for which you are organized. Therefore, **you should keep adequate records and case histories** that demonstrate that grants to individuals serve your charitable purposes. For example, you should be in a position to substantiate the basis for grants awarded to individuals to relieve poverty or under a scholarship or educational loan program. Case histories regarding grants to individuals should show names, addresses, purposes of grants, manner of selection, and relationship (if any) to members, officers, trustees or donors of funds to you.

For more information on the exclusion of scholarships from income by an individual recipient, see Publication 520, *Scholarships and Fellowships*.



