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Taxpayer Advocate Calls on IRS to Stop Erroneous Revocations.

The IRS needs to take steps to stop the erroneous revocation of some organizations' tax-exempt status for failure to file required information returns, the Taxpayer Advocate Service said in a report released January 9.

In her annual report to Congress, National Taxpayer Advocate Nina Olson addressed a Pension Protection Act provision that mandates the automatic revocation of exemption of any organization that does not file information returns or e-Postcards for three straight years. She said that since the policy took effect in 2010, about 9,000 of the roughly 550,000 automatic revocations have been made in error. Organizations that automatically lose their exempt status because of IRS mistakes may suffer by losing grants and donations, she said.

Olson said the errors were partly due to the IRS systems failing to recognize subordinate organizations as part of a group return when the subordinates and parent had different accounting periods. Another reason is a programming change that caused IRS computers to calculate the three-year nonfiling period as beginning when an organization received its employer identification number, not when it received its IRS determination letter.

"By computing the three-year nonfiling period with reference to the EIN date," the IRS exempt organizations function "is perpetuating erroneous revocations," Olson said.

Olson also faulted the IRS for including in the nonfiling period the periods in which filers of e-Postcards, which are submitted by smaller organizations, were waiting for their exemption applications to be processed. She said this is unfair because the code requires filing of the postcard but it cannot be done without IRS input.

"It is impossible to submit an e-Postcard in that period without assistance from the IRS," Olson said.

Olson made several recommendations. She said that when the IRS is about to treat an organization's exemption as automatically revoked, it should inform the organization and give it 30 days to correct the problem. The IRS also should clearly communicate the availability of administrative review "for organizations raising concerns [that] the IRS is proceeding in error," she said.

Also, when notifying organizations that they have failed to file, the IRS should explain that it calculates the nonfiling period by using the EIN and that they can contact the agency if that method could lead to erroneous revocation, according to Olson. The nonfiling period should not include the time during which an organization could not submit an e-Postcard without contacting the IRS, she said.

When asked to comment, the IRS did not address the erroneous revocations section of the report specifically. But it said it would review closely the report's overall contents and recommendations. It added that it is making progress on a number of issues addressed in the report, adding that it must balance limited resources to meet its dual mission of providing taxpayer service and enforcing the

tax laws.

Eve Rose Borenstein of the Borenstein and McVeigh Law Office LLC told Tax Analysts the TAS report “hits the nail on the head” in describing the problems with the IRS’s approach, in particular the agency’s “filing clock” administrative assumptions, such as the EIN reliance. “That assumption has exposed many organizations to erroneous revocation and attendant ‘reinstatement’ procedures, which typically surface once an organization files an initial exemption application,” she said. She agreed there needs to be a mechanism for administrative review.

The problem of erroneous revocations is not new. In May 2012 Lois Lerner, then director of exempt organizations in the IRS Tax-Exempt and Government Entities Division, said the IRS was more than willing to look at an organization that may have had its exemption revoked by mistake. Such organizations should approach the IRS, she said, adding that the agency had made corrections after the organizations had explained why the revocations were unwarranted.

by Fred Stokeld