

# Panel on the Nonprofit Sector

Convened by INDEPENDENT SECTOR

## Work Group Recommendations to the Panel on the Nonprofit Sector Posted for Public Comment January 24, 2005

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### #3: Penalties for Inaccurate or Incomplete Returns

#### I. Transparency and Financial Accountability Work Group Recommendations

##### A. Statement of Problem

Inaccurate and incomplete exempt organization returns deprive donors and regulators of timely, vital information and are a result of either a lack of knowledge; lack of required or accurate information; incompatibility of data collected and categorized; and/or intentional non-compliance. Outside preparers sign the Form 990 under penalties of perjury attesting that the return is true, correct, and complete. However, current preparer penalties are based on an understatement of tax liability and do not apply to preparation of information returns for exempt organizations.

##### B. Recommendations

1. Existing financial penalties imposed on organizations or organization managers for failure to file complete and/or accurate returns are sufficient and should be enforced.
2. Present-law tax penalties imposed on income tax return preparers for omission or misrepresentation of information, willful or reckless misrepresentation, or disregard of rules and regulations should be expanded to apply to preparers of Form 990 series returns.
3. The IRS should have the discretion to suspend or revoke tax-exempt status for failure to file required Forms 990, 990-EZ, or 990-PF for two consecutive years.
4. The IRS should be required to set up systems and notification procedures in coordination with sector-wide technical assistance.
5. Electronic filing of Forms 990 should be made mandatory as soon as possible.

Note: These recommendations have not yet been reviewed by the Panel on the Nonprofit Sector. They will be part of the deliberations by the Panel as it prepares its interim report.

### **C. Rationale**

Existing financial penalties provide a deterrent to non-compliance but are not enforced to an extent that improves the accuracy and completeness of returns. Increasing financial penalties would not necessarily improve compliance, but could present a hardship for charitable organizations for unintentional errors and omissions.

Surveys conducted by the IRS and National Center for Charitable Statistics indicate that approximately 80 percent of all 990s are prepared by professional tax professionals. Extending penalties to paid preparers of information returns, included in § 206 of the CARE Act as passed by the Senate in 2003, should improve compliance in a majority of cases.

Section 207(b) of the 2003 CARE Act provides for automatic revocation of tax-exempt status for failure to file after three years. Giving the IRS the discretion to suspend or revoke status after two years would provide a strong deterrent to non-compliance by those organizations that are engaging in willful or intentional misconduct, while avoiding automatic revocation for those organizations that did not receive appropriate notice from the IRS because they have moved and the IRS information has not been updated or their forwarding address information has expired. Two years provides enough time for education while still being aggressive enough to address potential negligence and fraud.

The IRS existing system (paper returns and outdated software) is highly ineffective and fraught with inaccurate notices and abated penalties. Improvements of the current system for assessing and collecting penalties and better documentation for abatement could increase compliance. The level of complexity to the information sought by the IRS is frequently well beyond the capabilities of the volunteers and organization employees who prepare returns. Non-compliance relating to lack of knowledge may be addressed through educational and technical assistance provided through partnerships between the IRS, state regulators, and nonprofit organizations and technical assistance providers.

Electronic filing (See Issue #4, Electronic Filing) will facilitate an efficient system for IRS collection of accurate and timely filed returns. E-filing software does not accept returns if incomplete. Internal consistency checks in the software should prevent most reporting errors.

### **D. Other Considerations**

The Work Group believes that mechanisms should be established to direct revenues from penalties and fines for non-compliance with rules for exempt organizations to funding for IRS Exempt Organization oversight and enforcement activities. Further, the Work Group recommends that there be greater coordination between IRS and state officials to improve compliance through both education and enforcement.

## **II. Expert Advisory Group Comments**

The Expert Advisory Group concurs with most of the Work Group's recommendation but strongly believes that the penalty for failure to file Form 990 series returns should be suspension, not revocation, of tax-exempt status. When the status is suspended, the organization is subject to taxes on its income and is no longer eligible to receive tax-deductible contributions and the IRS must post a public notice to that effect.