Appendix IV

Management's Response to the Draft Report

COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

RECEIVED,
FEB 16 2005

FEB 15 2005

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDIT
(SMALL BUSINESS AND CORPORATE PROGRAMS)

FROM: Steven T. Miller
Commissioner, Tax Exempt and Government Entities

SUBJECT: Response to Draft Audit Report: Review of the Exempt Organizations Function Process for Reviewing Alleged Political Campaign Intervention by Tax Exempt Organizations (Audit #200510008)

This responds to your draft audit report ("report") concerning the manner in which the Exempt Organizations ("EO") function of the Tax Exempt and Government Entities Division ("TE/GE") initiated and carried out a program aimed at addressing prohibited political activity by Internal Revenue Code section 501(c)(3) organizations during the 2004 election cycle.

Your review was prompted by requests from both the Commissioner of Internal Revenue and me to look critically at the new processes EO employed in the summer and fall of 2004 to review allegations of potential political activity by tax exempt organizations. Our requests to TIGTA were prompted by public charges, reported in the media, that TE/GE was examining alleged political activity by tax exempt organizations just before the 2004 Presidential election for politically motivated reasons or in response to political direction from outside the IRS.

Your report notes that, in conducting your review, TIGTA was "alert for any indications that inappropriate actions, such as political influence, may have been taken" with regard to EO's handling of the information items sent to it. The report also notes that if you had found inappropriate actions, you would have referred them to the TIGTA Office of Investigations for review.

In that regard, I am pleased that the report found:

- that you did not identify any indications that EO inappropriately handled information items you reviewed, and you did not make any referrals to the TIGTA Office of Investigations;
- that the EO Referral Committee followed a consistent process when reviewing information items, regardless of the source of the allegation or the nature of the alleged political activity;

- that you did not identify any cases in which the same criteria were used to select one information item for examination and to decline a similar item for examination; and
- that the information items EO selected and did not select for examination concerned organizations reflecting a variety of political views.

We are committed to enforcing the tax law that relates to tax-exempt organizations, including that portion of the tax law that restricts political intervention by 501(c)(3) organizations. The prohibited political activity program is but one aspect of this commitment, and was part of a larger effort that included both an educational and an enforcement component. We initiated our educational efforts well in advance of, and through, the 2004 election cycle. Our enforcement component involved the prohibited political activity program, which became more visible during the active part of the election cycle; that is when violations are likely to occur and when we are most likely to receive information items regarding potentially prohibited political activity by section 501(c)(3) organizations. Through both our educational and enforcement efforts, we were, and continue to be, equally committed to fulfilling our obligation to enforce the tax law without regard to partisan considerations or political direction.

I appreciate your insightful recommendations about actions we can take to improve the administration of our prohibited political activity program in future years. Furthermore, we are evaluating the program as it operated during the last election cycle. By the end of April, we expect to make a number of decisions on changes to the program for the next election cycle, beginning in 2006.

As we make these decisions, and when we begin to implement them, we will ensure that we fully address the problems you identified in the report. We therefore agree with your recommendations and indicate below how we intend to implement them. We do this, however, with the understanding that we may need to modify the manner in which we implement one or more recommendations depending on the changes we make to the program for the 2006 election cycle. We will keep you informed of any revisions to the way we implement any of the recommendations, should they become necessary.

Our response to your specific recommendations follows.

RECOMMENDATION 1

The Director, EO, should formalize the draft guidelines that detail how allegations of potential noncompliance with the tax law by tax exempt organizations should be classified.

CORRECTIVE ACTION
We have drafted, are circulating for approval, and will make effective procedures that, among other things, specify how allegations of potential noncompliance with the tax law by tax exempt organizations should be classified.

IMPLEMENTATION DATE
April 30, 2005.

RESPONSIBLE OFFICIAL
Director, EO.

CORRECTIVE ACTION MONITORING PLAN
This corrective action will be monitored in monthly operational reviews conducted with the Director, EO.

RECOMMENDATION 2
The Director, EO, should ensure time standards for accelerated case initiation (both classification and examination) are realistic for future election years based on available resources and priorities.

CORRECTIVE ACTION
We are drafting revised procedures for our prohibited political activity program for future election years. The procedures provide realistic timeframes, based on experience to date. These procedures will be evaluated as cases from the 2004 election cycle are closed, and additional data is collected. EO will revise the procedures further, if appropriate, and will disseminate revised procedures to the field by December 31, 2005, for the 2006 election cycle.

IMPLEMENTATION DATE
We will issue final procedures by December 31, 2005.

RESPONSIBLE OFFICIAL
Director, EO Examinations.

CORRECTIVE ACTION MONITORING PLAN
This corrective action will be monitored in bi-weekly conferences between the Director, EO and the Director, EO Examinations.

RECOMMENDATION 3
The Director, EO, should establish time standards for when potential political intervention allegations received in nonelection years should be evaluated for

examination potential and sent to the examination groups, rather than just assigned to an examiner as currently required.

CORRECTIVE ACTION
We have drafted and are implementing procedures establishing set periods within which we will (a) assign information items alleging potential political intervention in non-election years to a classifier, and (b) either send the item from classification to a group or determine that an examination is not warranted.

IMPLEMENTATION DATE
April 30, 2005.

RESPONSIBLE OFFICIAL
Director, EO Examinations.

CORRECTIVE ACTION MONITORING PLAN
This corrective action will be monitored in bi-weekly conferences between the Director, EO and the Director, EO Examinations.

RECOMMENDATION 4
The Director, EO, should ensure any future expedited review process is initiated early enough in an election year to ensure classification and examination actions are completed timely and consistently.

CORRECTIVE ACTION
We have drafted, and the Director, EO Examinations, is now considering, procedures for future election years that cover the start of the prohibited political activity program and ensure that the process is initiated early enough to allow classification and examination actions to be completed timely and consistently. We will issue these procedures by December 31, 2005, for the 2006 cycle.

IMPLEMENTATION DATE
December 31, 2005.

RESPONSIBLE OFFICIAL
Director, EO Examinations.

CORRECTIVE ACTION MONITORING PLAN
This corrective action will be monitored in bi-weekly conferences between the Director, EO and the Director, EO Examinations.

RECOMMENDATION 5
The Commissioner, TE/GE, should issue a press release in future election years if allegations of potential noncompliance with the tax laws will be processed on an expedited basis, to increase public awareness of the expedited process.

CORRECTIVE ACTION
The Commissioner, TE/GE, has requested the Director, Communications and Liaison, TE/GE, to prepare a press release in future election years, for release in advance of the commencement of future prohibited political activity programs, advising the exempt organizations community that allegations of potential noncompliance with the tax law relating to political activity will be processed on an expedited basis. The Director, Communications and Liaison, TE/GE, has entered this assignment on his calendar system for 2006.

IMPLEMENTATION DATE
Completed.

RESPONSIBLE OFFICIAL
Commissioner, TE/GE.

CORRECTIVE ACTION MONITORING PLAN
No monitoring is required because the corrective action is completed.