

New IRS Tax Exempt Compensation Enforcement Project

On August 10, 2004, the IRS announced a new enforcement effort aimed at identifying (and eliminating) the provision of excessive compensation and other forms of financial benefits by tax-exempt organizations to their officers, directors or other insiders. The announcement of what is now called the “Tax Exempt Compensation Enforcement Project” was made by the issuance of a news release (IR-2004-106), and was accompanied with a telephone news conference conducted by Steven Miller, Assistant Commissioner for Tax-Exempt/Government Entities at the IRS.

The news release stated that “the IRS will contact nearly 2,000 charities and foundations to seek more information about their compensation practices and procedures.” The enforcement project will include audits as well as other forms of contacts with exempt organizations that may develop into audits, such as letters (similar to IRS Information Document Requests) asking for details concerning compensation practices and procedures, and possibly specific inquiries developed as a result of information reported on an organization’s Form 990.

The enforcement project is aimed at detecting excessive compensation and improper compensation practices that may result in private inurement or more than incidental private benefit, and, especially, excess benefit transactions under the intermediate sanctions rules.

One objective of the enforcement project is to gather more information regarding current compensation practices in order to assist the IRS in its redesign of Form 990 to elicit more detailed and sophisticated information relating to compensation practices, and, eventually, to stimulate improved compliance with tax law standards. Without question, however, another major objective of the enforcement project is to curb abuses that have been reported and are being discovered as a part of the work of the IRS’ Intermediate Sanctions Task Force. Harsh criticism from Congress (including, specifically, the Chairman of the Senate Finance Committee) regarding the absence of a strong IRS enforcement program concerning exempt organization compensation abuses has also been an important contributing factor to the IRS announcement of this enforcement project.

The enforcement project began in late July and is expected to continue into 2005 (and, depending upon the information developed, probably into the indefinite future). This enforcement project is certain to have a significant impact on literally thousands of exempt organizations. Such enforcement effort undoubtedly will include the imposition of significant penalty taxes on so-called “excess benefit transactions” under the intermediate sanctions rules.

We recommend that exempt organizations conduct a self-audit that includes a review of compensation practices and policies, as well as conflicts of interest policies and procedures to assure that any insider transactions are properly reviewed and approved in an entirely independent and objective manner. Taking this kind of action now could help avoid a more serious problem later.

How We Can Help

Duane Morris has a complete package of services to help exempt organizations conduct self-examinations, determine vulnerability to intermediate sanctions or other types of adverse tax consequences, and to correct deficiencies that are discovered. We also have educational materials for exempt organizations and their officers, directors and employees. We can also help an organization that receives call from the IRS.

For Further Information

For further information about the Tax Exempt Compensation Enforcement Project and about intermediate sanctions compliance, which we believe to be at the heart of this enforcement project, please contact David M. Flynn at 215.979.1947 or dflynn@duanemorris.com or the lawyer in the firm with whom you are regularly in contact.