



Highlights of [GAO-05-561T](#), a testimony before the House Committee on Ways and Means

Why GAO Did This Study

The tax-exempt sector under section 501(c) of the Internal Revenue Code covers over a million-and-a-half entities of varying sizes and purposes. Its diversity allows it to address the needs of many citizens. To help it do so, Congress and some in the tax-exempt sector itself encourage good governance practices by exempt entities. Transparency over exempt entities' activities is aided by public access to their annual tax returns. As the nation's tax administrator, the Internal Revenue Service (IRS) has a key role in overseeing this sector. Oversight can help ensure adherence to exempt purposes, protect against abuses, and sustain public support for the sector.

The Chairman of the House Committee on Ways and Means asked GAO to address (1) the growth of the section 501(c) tax-exempt sector; (2) the role of governance and transparency in ensuring that tax-exempt entities function effectively and with integrity; (3) IRS's capacity for overseeing the exempt sector, including its results and efforts to address critical compliance problems; and (4) states' oversight and their relationship with IRS in overseeing the tax-exempt sector.

What GAO Recommends

GAO makes no recommendations but suggests a full re-examination of the tax-exempt sector in light of the challenges facing the nation in the 21st century.

www.gao.gov/cgi-bin/getrpt?GAO-05-561T. To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov.

TAX-EXEMPT SECTOR

Governance, Transparency, and Oversight Are Critical for Maintaining Public Trust

What GAO Found

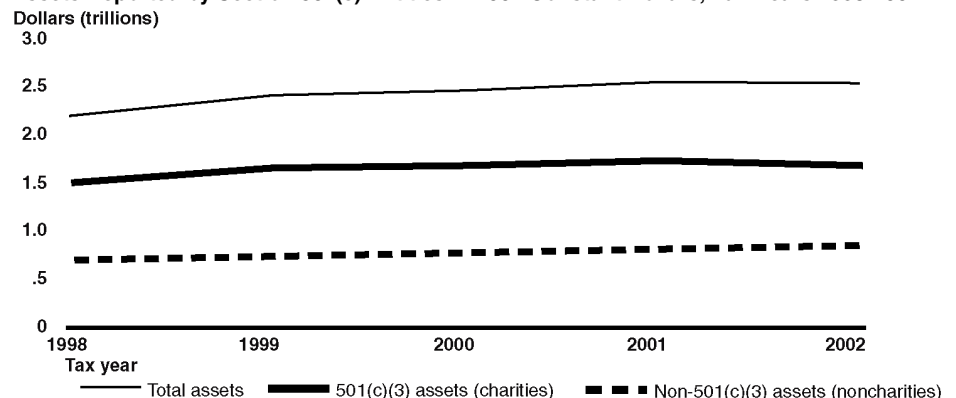
The section 501(c) tax-exempt sector has grown steadily in reported assets, revenues, and expenses. For example, between 1998 and 2002 (the most recent year of data), its reported assets grew to over \$2.5 trillion—with 12 percent growth for 501(c) charities and 22 percent growth for other 501(c) entities (noncharities). Accordingly, this tax-exempt sector comprises a significant part of the nation's economy and workforce. For example, spending in this sector appears to be about one-tenth of our economy and the paid exempt workforce appears to be comparable in size to some of the largest sectors of the U.S. civilian workforce, such as food and lodging.

Good governance and transparency are essential elements to help provide assurance that exempt entities operate with integrity and effectiveness in meeting their missions. Good governance facilitates well-run operations that dissuade abusive behavior. Transparency sheds light on entities' practices, which enhances ethical and effective operations and facilitates oversight by the public and others. With recent concerns about abuses in the tax-exempt sector, renewed attention is being given to improving governance practices and increasing the transparency related to the sector.

Staffing trends and insufficient data have contributed to IRS being challenged in executing its oversight role. IRS has begun to increase staffing, obtain better data on tax-exempt entities, and increase its capacity to analyze and use the data it obtains. For the critical compliance issues IRS has identified, it has started special initiatives to improve compliance.

States often oversee tax-exempt entities, frequently focusing on protecting the public from fraudulent activities and guarding against misuse of charitable assets. States and the IRS believe that more data sharing would make their oversight more efficient and effective. Consistent with our earlier recommendations, IRS has improved its processes for sharing its oversight data with the states, and Congress is considering expanded data sharing.

Assets Reported by Section 501(c) Entities in 2004 Constant Dollars, Tax Years 1998-2002



Source: Tabulation of data from IRS's Return Inventory Classification System, 1998-2002.