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Mandated E-Filing: Toward a More Transparent Nonprofit Sector

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The IRS Form 990 series provides critical transparency and accountability for the nonprofit sector and is the primary source for basic information on the nonprofit sector taken as a whole. However, a considerable lag exists between the time organizations submit their forms and when the public has access to data files based on the forms, making up-to-date information on the sector almost nonexistent. Many organizations file their returns electronically, including most of the largest nonprofits, which are required to do so. However, many organizations still file paper returns, which limits IRS ability to provide timely data on the nonprofit sector. In response to this problem, the Obama administration's 2014 budget proposal authorizes the IRS to require electronic filing (e-filing) of returns filed by all tax-exempt organizations. While mandatory e-filing of these forms will yield more robust and timely data for potential donors, nonprofit managers, regulators, and researchers, some observers are concerned about the potential impact on paper filers and tax preparers. In this brief, we will examine this concern in more detail and report findings from a small survey of certified public accountants, thought by some to be opposed to e-filing, that shows instead that they are widely in favor of it.

Introduction

The IRS now requires the Form 990 (and its variants, 990-EZ and 990-PF) for all tax-exempt organizations with more than $50,000 in annual revenues, with the exception of religious congregations, which have no annual filing requirement. The Forms 990 provide public information about nonprofit finances, governance, and operations; yield data for analysis about the growth and functions of the nonprofit sector; and help donors and other stakeholders assess a given organization or group of organizations. In short, the forms are integral to the transparency of the nonprofit sector. However, the effectiveness of these forms as transparency tools diminishes the longer it takes public and nonprofit stakeholders to have access to the data. It currently takes many months from the time an organization submits its return to the IRS to make the information from these forms available as data to the public.

For many years, a sizable number of nonprofit organizations have filed their 990 forms electronically. Many observers have proposed ways to increase the prevalence of e-filing, but in April 2013, the administration of President Barack Obama proposed to make e-filing mandatory for all tax-exempt organizations in its 2014 budget request to Congress.[2] Supporters of e-filing are enthusiastic about the potential for increased IRS capacity to deliver timely and accurate data about nonprofit organizations. Others worry that mandatory e-filing will cause disruption within the nonprofit sector, particularly among small to mid-sized nonprofits that file paper returns, and among the tax preparers—typically CPA firms—that help them file the forms.

Using both data from the IRS and a sample of 3,000 organizations filing Forms 990 or 990-EZ in FY 2009 or later, this brief looks at the trends in e-filing among organizations filing Forms 990 and 990-EZ over the past 10 years and provides a snapshot of those currently filing their returns electronically.[3] The brief concludes by presenting findings from a survey of CPAs, which suggests that nonprofits that need assistance with e-filing would have little trouble finding the help they need.

E-Filing Implementation Background

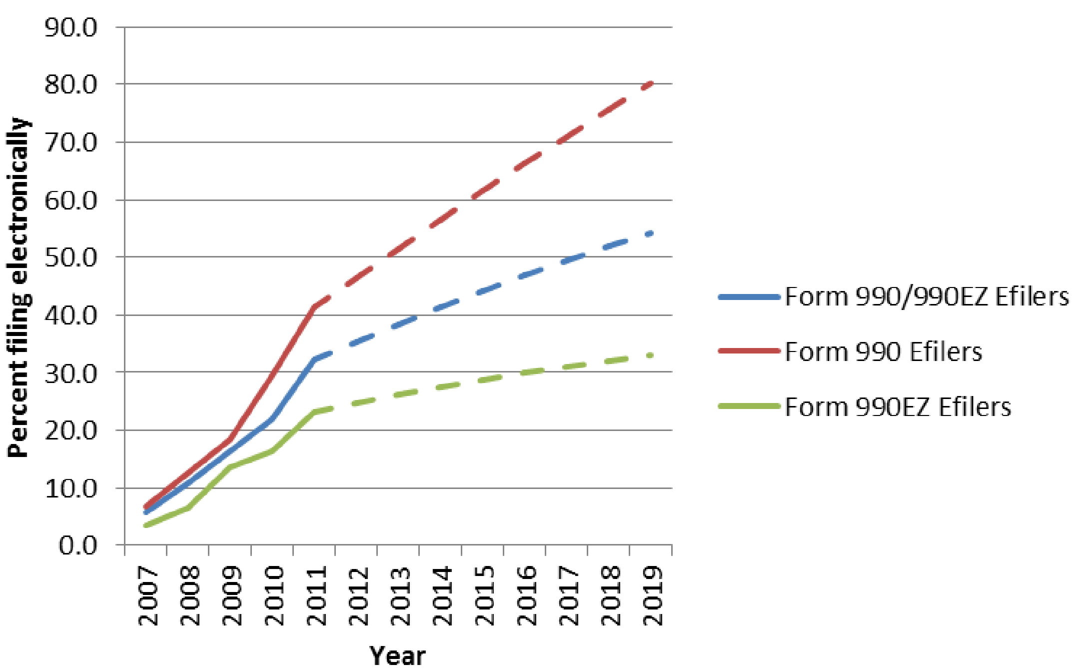
The IRS began accepting electronically filed returns for tax-exempt organizations in 2004.[4] With its *Form 990 Online*, NCCS at the Urban Institute was the first nonprofit or for-profit organization to develop an approved system that nonprofit organizations and their preparers could use to complete and electronically file their Forms 990. Initially, electronic filing was voluntary for all tax-exempt organizations. In 2006, however, the IRS introduced size-based mandatory electronic filing for nonprofits—first requiring nonprofits to e-file if they filed 250 or more IRS forms per year and had $50 million in assets, then dropping the asset threshold to $10 million in 2007.[5] (In practical terms, this means that an organization must have at least 245 employees or consultants on its books in a given year for whom it completed IRS W-2 or 1099 Forms, plus four quarterly Form 941s for reporting employee income tax withholding, plus the Form 990.) In 2011, approximately 10,000 organizations, or 2 percent of Form 990 and 990-EZ filers, were required to file electronically.[6]

The Pension Protection Act of 2006 (PPA) further expanded mandatory electronic filing by requiring nearly half a million nonprofit organizations with less than $25,000 in annual gross receipts (which previously had no filing requirement) to electronically file the newly created Form 990-N (e-Postcard). While the e-Postcard collects only the most basic information, the new filing requirements, coupled with the usability and easy accessibility of the electronically filed data, meant that the IRS could confirm the continued operations of over 400,000 smaller nonprofits.[7] The PPA e-Postcard filing requirements also resulted in the IRS revoking tax-exempt status for nearly 300,000 organizations that did not file the 990-N for three consecutive years and removing them from the IRS lists of active organizations, yielding a much clearer picture of the nonprofit sector.[8] NCCS also surveyed a small number of organizations that did not file the e-Postcard and found that the overwhelming majority of them were, in fact, no longer functioning.

Where We Are Now

As of early 2013, both the smallest and largest tax-exempt organizations are required to electronically file their returns. However, no e-filing requirements exist for approximately 420,000 mid-sized organizations[9]—those required to file a Form 990 or 990-EZ, that file fewer than 250 returns annually, and have less than $10 million in assets. These mid-sized organizations account for 98 percent of organizations filing Forms 990 or 990-EZ.

Figure 1. Actual and Projected Electronic Filing of Forms 990 and 990-EZ, 2007–19



Sources: Internal Revenue Service, original data from Office of Forecasting and Data Analysis (April 2012); Internal Revenue Service, Publication 6186 (October 2012).
Note: A dashed line indicates projected numbers.

To date, policymakers have made little effort to increase electronic filing among these mid-sized organizations. E-filing requirements have focused only on the largest organizations, which account for just 2 percent of Form 990 and 990-EZ filers. The president's FY 2013 budget request sought to boost electronic filing among nonprofits by giving the Treasury Department authority to lower the current 250-return threshold.[10] It made no mention, however, of lowering the asset threshold below $10 million. Considering that nearly 95 percent of tax-exempt organizations filing the Form 990 or 990-EZ hold less than $10 million in assets, mandating e-filing without lowering or removing the asset threshold is an ineffective approach to increasing the overall electronic filing rate of nonprofits.

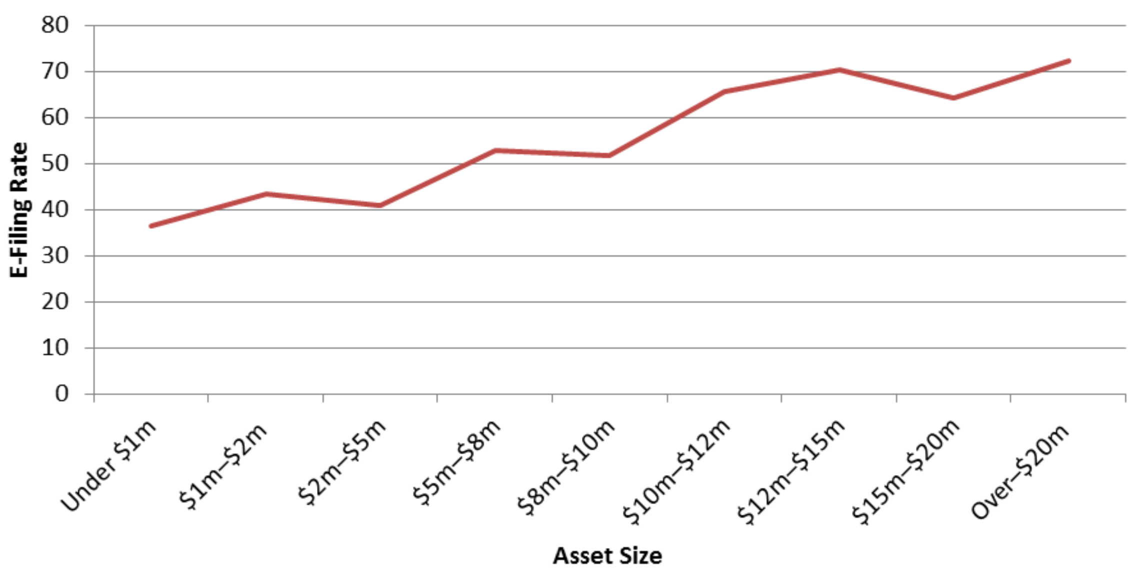
Some argue there is limited value in expanding electronic filing requirements beyond the 2 percent already required since these organizations account for approximately 67 percent of the revenues and 63 percent of the assets of exempt organizations filing a Form 990 or 990-EZ.[11] This, argument, however, underestimates the substantial role that the smaller or mid-sized organizations play in community life and their role as the face of the nonprofit sector for many donors and members of the general public. It also ignores the potential cost savings for federal and state governments, and research and watchdog organizations, as well as the improvements in timeliness and transparency that would occur, if e-filing requirements were broadened.

E-Filing Trends

1. E-filing frequency is projected to increase

In 2004, the IRS initiated voluntary electronic filing for tax-exempt organizations. Just over 4,000 organizations filed their returns electronically that first year, but this number has been increasing steadily. Figure 1 displays the percentage of organizations e-filing their Forms 990 and 990-EZ over the past five years as well as the projected electronic filing rates through 2019. In 2007, just 6 percent of nonprofits e-filed their returns, compared with 32 percent in 2011. Electronic filing has grown

Figure 2. Form 990 and 990-EZ Electronic Filing Rates by Asset Level, 2011–12



Source: IRS Business Master File, October 2012; National Center for Charitable Statistics, Electronic Filing Sample November 2012.

faster for Form 990 than for Form 990-EZ. In the past five years, the Form 990 e-filing rate increased from 6.6 percent to 41.3 percent, while the Form 990-EZ e-filing rate has grown from 3.5 percent to 23.3 percent.

While the IRS projects that e-filing of both forms will continue to rise without changes to the law, it predicts significantly greater growth in electronic filing among Form 990 filers. In fact, the IRS projects that the Form 990 e-filing rate will nearly double from 2011 to 2019, while the projected growth of e-filing among Form 990-EZ filers will be a mere 10 percentage points over the same period. All told, given current trends in e-filing, a projected 43 percent of all nonprofits—over 675,000 organizations—will still be filing paper returns in 2019 if allowed to do so.

2. Large nonprofits are much more likely to file electronically than small nonprofits

Currently, larger organizations e-file at higher rates than smaller organizations. Thirty-six percent of organizations with less than $1 million in assets filed electronically in 2011, compared with 63 percent of organizations with $5 million or more in assets (figure 2). In fact, almost all organizations meeting the current electronic filing requirements ($10 million or more in assets and filing at least 250 returns per year) filed electronically in 2011.[12] However, only 2 percent of nonprofit organizations meet these requirements; smaller organizations comprise the vast majority of organizations filing the Form 990 or 990-EZ. Organizations with less than $1 million in assets account for approximately 76 percent of filers, while organizations with $5 million or more in assets account for only 7 percent.[13]

3. Paid preparers are more likely to file electronically

Until the most recent proposal in the president's budget request, all current and proposed mandated e-filing requirements have been limited to only the largest nonprofit organizations. While it is logical to assume that the burden on smaller organizations might outweigh the benefit of requiring electronic filing if smaller organizations are saddled with purchasing costly new

Table 1. Returns Filed by Paid Preparers by Type of Form and Size, 2011–12

	Number of organizations	% filed by paid preparer	E-filing rate of returns filed by paid preparers
All	429,247	83.0	44.4
Type of Form			
Form 990-EZ	178,961	73.5	39.8
Form 990	250,286	89.2	46.9
Asset Size (Form 990 Only)			
Under $1 million	145,715	88.8	42.7
$1 million – $2 million	31,410	94.5	44.5
$2 million – $5 million	29,966	91.0	43.2
$5 million – $8 million	11,086	90.8	53.6
$8 million – $10 million	4,427	88.9	51.9
$10 million – $12 million	3,204	94.8	64.5
$12 million – $15 million	3,424	90.4	70.8
$15 million – $20 million	3,796	88.3	68.0
Over $20 million	17,258	77.9	78.9

Source: IRS Business Master File, October 2012; National Center for Charitable Statistics, Electronic Filing Sample November 2012.

software to electronically file their own returns, our analysis finds that the vast majority of nonprofits use a paid preparer to file their Forms 990 and 990-EZ. In fact, as table 1 shows, paid preparers filed 83 percent of all Forms 990 and 990-EZ in 2011.[14]

Organizations filing a Form 990 used paid preparers at a slightly higher rate than those filing Forms 990-EZ, 89 percent compared with 74 percent. Among those organizations filing Forms 990, paid preparers filed around 90 percent of returns across most size categories. Organizations with $20 million or more in assets had the lowest rate of returns filed by paid preparers, 78 percent, suggesting they have finance staff filing their tax forms.

Returns filed by paid preparers are electronically filed at higher rates than returns filed directly by organizations themselves, 44 percent compared to 18 percent. There is still much room for improvement in the rates. Table 1 displays the electronic filing rates of forms prepared by paid preparers by form type and by size. Paid preparers filing Forms 990 e-file at higher rates than paid preparers filing Forms 990-EZ. Forty percent of Forms 990-EZs filed by a paid preparer are electronically filed, compared with 47 percent of Forms 990. If we look just at Forms 990 filed by a paid preparer, organizations with less than $5 million in assets, which account for 83 percent of Form 990 filers, electronically file at lower rates than larger organizations. Forty-three percent of organizations with less than $5 million in assets electronically file, compared with 65 percent of organizations with $5 million or more in assets.

With paid preparers filing over 80 percent of tax-exempt information returns, it is worth considering electronic filing requirements for paid preparers rather than focusing solely on large organizations as the IRS is doing now. Currently, Congress is not considering legislation to mandate electronic filing by paid preparers of tax exempt information forms. However, the Worker, Homeownership, and Business Assistance Act of 2009 now requires paid tax preparers that file 11 or more individual income tax returns per year to file those returns electronically. This precedent could be expanded to encompass paid preparers filing returns for tax-exempt organizations.

4. Mandatory e-filing could help states modernize filing processes

Thirty-nine states and the District of Columbia require nonprofit organizations that are active in their states to register if the organizations meet a variety of state-specific criteria based, most frequently, on the amount of contributions they receive from the public or, in other cases, on their size as measured by either their total revenues or charitable assets. These requirements are generally focused on 501(c)(3) public charities.

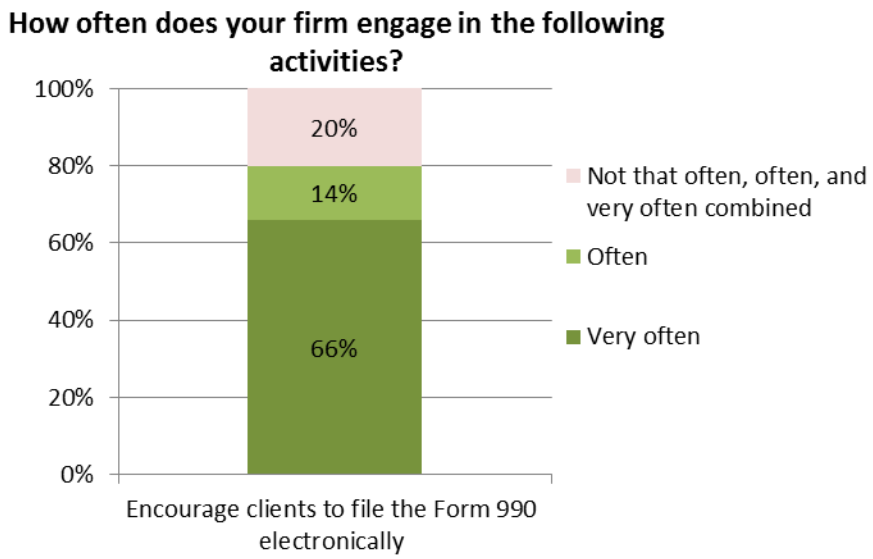
In addition to the state registration and annual renewal forms, most of these state charity offices (usually overseen by either the state attorneys general or secretary of state) require submission of the organizations' most recent IRS Form 990 or 990-EZ. In an analysis of 2011 and 2012 returns, we found that 50.9 percent of organizations filing a Form 990 or Form 990-EZ also submitted a copy of the form to one or more states. As expected, a greater proportion of 501(c)(3) public charities filed their forms with one or more states than "other" tax-exempt organizations, 57.2 percent compared with 36.7 percent.

Currently, only Michigan, Hawaii, California, and New York are able to accept an electronically filed Form 990 or 990-EZ. Most states will accept a copy of the most current Form 990 or 990-EZ either attached to the physical annual financial report or attached as a PDF to an electronically filed state form. The usability of these forms as regulatory tools diminishes, though, if the information from these forms cannot be linked up with the state forms and searched and analyzed as data.

Although the potential benefits to nonprofit organizations and the public from increases in electronic filing are great, state charity offices seeking to institute e-filing would have to bear some of the implementation costs. While some state charity offices already have the authority to require electronic filing, others would need to get formal statutory authority to do so—a difficult proposition in some states where measures like this are competing for limited time and attention from both the executive and legislative branches. Moreover, if additional funding is required, then state charity officials face additional hurdles in the many states working with tight budgets.[15]

However, many states have strong incentives to require electronic filing. Receiving state registration forms, including the Form 990 and Form 990-EZ, in electronic format will greatly increase the ability of state charity officials to monitor nonprofit organizations in their state and will free resources that may be currently spent on processing paper forms to enable state oversight. State e-filing requirements have the additional value of capturing basic financial information from organizations that actively fundraise but that have revenues below $50,000. In Illinois, for example, organizations with more than $15,000 in contributions provide basic information on their total assets, revenue, and

Figure 3. Respondents by frequency of encouraging nonprofit clients to e-file



Source: National Center for Charitable Statistics, Survey of CPAs, 2012.

expenses[16]—information that helps potential donors and people interested in the civic capacity of communities distinguish inactive organizations that may have filed e-Postcards with the IRS from those that are truly active.

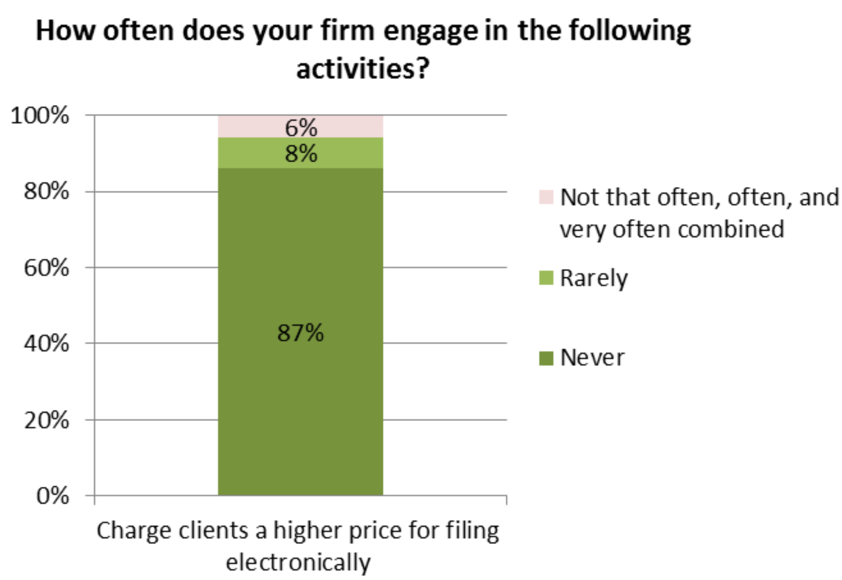
What Paid Preparers Think

In 2002, prior to the availability of Form 990 e-filing through the IRS, the National Center for Charitable Statistics (NCCS) surveyed nonprofit organizations to assess their willingness to electronically file IRS Forms 990.[17] The survey found that the overwhelming majority of organizations would be willing to e-file. Yet e-filing rates, while growing exponentially since federal e-filing became available nearly 10 years ago, remain lower than predicted from the survey results. There are a number of possible explanations for this, but one that has remained unexamined until now is the attitudes of certified public a accountants (CPAs) who typically conduct financial audits of larger organizations and complete their Forms 990.

To gauge the preferences of potential nonprofit tax preparers for e-filing, NCCS surveyed CPAs in Pennsylvania and several other states in 2012. The responders remain anonymous. Among 211 responses received, approximately half are from CPAs in Pennsylvania, using a list of CPAs working with nonprofit organizations in the state, and the rest were from the following states (listed in order of most responses): Washington, California, Texas, New York, Connecticut, Florida, Illinois, Louisiana, New Mexico, and Mississippi.[18]

While not a representative sample, the responses are instructive. The majority of CPA firms that responded (61 percent) prepare relatively few (less than 25 Forms 990) per year. Just under one in five (17 percent) prepared between 25 and 50 Forms 990, and the same percentage prepared more than 50 Forms 990 per year. Five percent did not prepare Forms 990. Approximately one in five CPAs do no e-filing, more than one in three do a very high percentage, and 42 percent do a mix of paper and e-filing.

Figure 4. Respondents by frequency of charging a higher price for filing electronically



Source: National Center for Charitable Statistics, Survey of CPAs, 2012.

Two-thirds of the firms stated they “very often” encourage their clients to file the Form 990 electronically and another 14 percent said they “often” encourage their clients to e-file. Just 20 percent said they never, rarely, or “not that often” encourage clients to e-file (figure 3).

In addition to encouraging clients to e-file, responding CPA firms reported a price-neutral stance on charging for e-filing. As figure 4 shows, firms do not charge more for e-filing forms as a rule (95 percent never or rarely charge more). But CPAs do not charge less for e-filing forms either: 91 percent never or rarely give a discount for e-filing.

CPAs who responded to the survey identified several benefits of e-filing for their clients. Commonly cited benefits include instant notification that a Form 990 is accepted (or needs correction), ease of sharing information electronically, direct client (nonprofit organization) participation in preparing the Form 990, and reduced office and handling costs.

Despite encouragement and a price-neutral impact on their accounting fees, some clients do not ask (or actively do not want) their CPAs to file the Form 990 electronically. The CPAs discussed these barriers to e-filing in their responses to follow-up questions. The most common reason for not filing Forms 990 electronically is that organizations cannot e-file tax returns to their states. About one in eight CPAs surveyed (12 percent) identified this as a barrier for their firm’s engagement in e-filing, and nearly one in five (18 percent) said this affected their clients’ decisions not to e-file. The next most cited reason for not e-filing was that additional schedules or forms required from clients are not available electronically. About one in ten (11 percent) identified this as a barrier from the CPA perspective, and a similar percentage (10 percent) identified it as a concern for their clients.

CPAs also identified client anxieties with the technical aspects of e-filing as an area of concern. Nine percent said their clients do not want to e-file because they find the electronic software too difficult, and 9 percent said their clients lack the necessary technological skills to e-file. A popular write-in response was that the process of getting signatures from organizational representatives on e-filed forms can be a challenge, both for the firms and for the clients.

Conclusion

While electronic filing by tax-exempt nonprofits has steadily increased over the past five years, policymakers have shown little interest in mandating electronic filing of IRS Form 990 or 990-EZ until recently. Strategies to this point have focused solely on the largest organizations, which account for less than 2 percent of nonprofit filers. In prior years, the Obama administration has proposed expanding electronic filing requirements among larger organizations. While those proposals would have affected only a small percentage of nonprofit filers, authorization for mandatory e-filing for all filers, as proposed in the president’s 2014 budget request, would change the landscape for the public, regulatory officials, watchdog groups, and research organizations.

This approach would provide comprehensive data on the sector to the public more quickly and accurately. A regulatory strategy to increase electronic filing must target the mid-sized organizations that comprise the majority of tax-exempt filers. To the extent that states could expand state-level requirements for electronic filing, the sector will benefit from providing a seamless system that nonprofits and preparers could use to complete both their state and federal returns and helping nonprofits become accustomed to e-filing.

Methodology

This brief uses a variety of data sources to determine electronic filing rates of Form 990 and Form 990-EZ filers. The overall electronic filing rates and electronic filing rates by type of form are from IRS Publication 6186—Calendar Year Return Projections for the United States and IRS Campuses (October 2012) and from original data from the IRS Office of Forecasting and Data Analysis. In order to estimate the electronic filing rates by size of organization and type of preparer (organizations versus paid preparer), a stratified random sample of 3,000 tax-exempt organizations was drawn from the IRS Business Master File (October, 2012) of a sampling frame of 429,247 tax-exempt organizations that have filed a complete Form 990 or Form 990-EZ for FY 2009 or later and was processed by the IRS in the last year (September 2011 to August 2012). Oversampling was done in the larger size categories to get a better sense of the impact of expanded size-based e-filing mandates. The sample was then weighted to reflect the overall tax-exempt population.

Notes

1. The survey of CPAs discussed in the last section of this brief could not have been completed without the research assistance of Shatao Arya.
2. US Office of Management and Budget, "Strengthening and Supporting Non-Profits, Philanthropic, Faith-Based and Other Community Organizations Working to Grow the Middle Class," http://www.whitehouse.gov/omb/budget/factsheet/strengthening-and-supporting-non-profits.
3. This study excludes 501(c)(3) private foundations, which file Form 990-PF, and organizations that electronically file 990-N (e-Postcard).
4. Internal Revenue Service. *IRS E-File: A History, June 2011*. http://www.irs.gov/uac/IRS-E-File:-A-History.
5. Section 6011(e)(2)(A) of the Internal Revenue Code, enacted by Congress and implemented in the mid-1980s to protect small businesses from having to submit large magnetic tape reels to the IRS, provide that any person, including a corporation, partnership, employer, estate, or trust who files 250 or more information returns, such as Forms 1042-S, 1097-BTC, 1098, 1099, 3921, 3922, 5498, 8027, W-2, and W-2G for any calendar year, must file these returns electronically. To change this requires congressional action.
6. Estimates based on Statistics of Income Files, 2009,
7. Roeger, Katie. August 2011. *Small Nonprofit Organizations: A Profile of 990-N Filers*. Washington, DC: The Urban Institute.
8. Blackwood and Roeger. August 2011. *Revoked: A Snapshot of Organizations That Lost Their Tax-Exempt Status*. Washington, DC: The Urban Institute.
9. Estimate based on IRS Business Master File, October 2012, and IRS Statistics of Income Files, 2009.
10. At the time of publication the FY 2014 budget request had not been submitted to Congress.
11. Estimates based on IRS Statistics of Income Files, 2009.
12. An organization may request a waiver from the electronic filing requirement if it cannot meet the requirement due to technology constraints or if compliance with the requirement would result in undue financial burden. See http://www.irs.gov/irb/2010-04_IRB/ar14.html for more information.
13. IRS Business Master File, October, 2012.
14. We should also note that the Urban Institute provides a web-based Form 990/990-EZ preparation and electronic filing system for free to organizations with less than $100,000 in gross receipts and at very low cost for larger organizations.
15. A shared "single portal" electronic filing system that will be used by nonprofit organizations to file (initially) in a dozen states is in the early stages of development by the National Association of State Charity Officials, with support from the Urban Institute.
16. http://illinoisattorneygeneral.gov/charities/reg_reports.html.
17. Poletz, Pollak, and Lampkin. 2002. *Charities Ready and Willing to E-file: Final Report*. Retrieved from http://www.urban.org/publications/410524.html.
18. Pennsylvania was initially chosen because a list of CPAs working with nonprofits was readily available and also for the diversity of this large state. Later, we expanded the survey sample to include respondents from other states to reduce the impact of any potential geographic bias.

The National Center for Charitable Statistics is a project of the Center on Nonprofits and Philanthropy at the Urban Institute. Please visit nccs.urban.org for more detail.

About the Authors

The authors of this paper are all members of the NCCS analysis team.

About the Form 990 E-Filing Initiative

The Form 990 E-Filing Initiative is sponsored by NCCS, a project of the Urban Institute's Center on Nonprofits and Philanthropy. A collaboration with the Aspen Institute, Foundation Center, Greater Washington Society of CPAs, GuideStar, Independent Sector, National Council of Nonprofits and United Way Worldwide, the initiative aims to increase knowledge and understanding of Form 990 e-filing among policymakers and the general public. Find out more at http://www.nccs2.org/wiki/index.php?title=Form_990_e-Filing_Initiative or send an email to nccs@urban.org if you'd like to follow the latest developments on e-filing.