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REPORT TO THE CONGRESS

72-0302



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Determination Of Nonprofit
Organizations' Eligibility
For Reduced Postage Rates
Should Be Improved B-114874

United States Postal Service

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BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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APRIL 4, 1972



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114874

To the President of the Senate and the
Speaker of the House of Representatives

This is our report entitled, "Determination of Nonprofit Organizations' Eligibility for Reduced Postage Rates Should Be Improved."

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Postal Reorganization Act of August 12, 1970 (39 U.S.C. 2008).

Copies of this report are being sent to the Director, Office of Management and Budget; the Postmaster General; and each member of the Board of Governors of the United States Postal Service.

A handwritten signature in black ink, reading "James B. Stacks".

Comptroller General
of the United States

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WHY THE REVIEW WAS MADE

By law, certain types of nonprofit organizations can qualify to mail matter at reduced second- and third-class postage rates. The reduced rates range from 23 to 60 percent less than the regular rates. Postal Service information shows that costs attributed to such nonprofit mail exceeded revenues by \$53 million in fiscal year 1970. (See pp. 5 and 6.)

Nonprofit religious, educational, scientific, philanthropic, agricultural, labor, veterans, or fraternal organizations qualify for reduced second- or third-class postage rates, and certain others may mail at the reduced second-class rates. Such organizations as business leagues, citizens' and civic improvement associations, and social clubs are not eligible for reduced postage rates. (See pp. 5 and 8.)

The General Accounting Office (GAO) wanted to know whether the Department was making proper eligibility determinations.

FINDINGS AND CONCLUSIONS

The Department had not been making, in all cases, proper determinations of the eligibility of nonprofit organizations for reduced rates, and, as a result, the Department has not collected substantial revenues to which it is entitled. (See p. 7.)

GAO reviewed at five post offices the mailing privileges of 1,135 organizations whose eligibility for reduced rates seemed questionable and concluded that 115 organizations--84 business leagues, 21 citizens' and civic improvement associations, and 10 social clubs--did not qualify. (See p. 14.)

The Department handled 71.6 million pieces of mail at the reduced second- and third-class rates for the 115 organizations in a 1-year period. On this basis the Department undercharged these groups by \$1.5 million. (See p. 14.)

The Department did not have adequate criteria for use by postal personnel to determine eligibility of nonprofit organizations for reduced postage rates. Some of the 115 organizations were granted nonprofit mailing privileges at one or more post offices, while the same or similar organizations were denied the same privileges at other post offices. (See p. 7.)

In view of the estimated 6.1 billion pieces of second- and third-class nonprofit mail handled annually nationwide and in view of the lack of adequate criteria for determining an organization's eligibility for reduced postage rates, GAO believes that the amount of lost revenue could be significant nationwide. (See p. 6.)

Local postal officials generally agreed that the Department's criteria were not adequate for evaluating applications for reduced postage rates. (See p. 18.)

The Internal Revenue Service (IRS) classifies nonprofit organizations by type for Federal income tax purposes on the basis of examinations of the purposes and activities of the organizations and examinations of financial information. (See p. 10.)

GAO concluded that IRS classifications should be considered when approving or denying applications for reduced-rate mailing privileges because IRS made more thorough examinations of, and had more specific criteria in determining, organizations' purposes and activities. (See p. 12.)

After GAO discussed its preliminary findings with a Department headquarters official, the Department revised its regulations in January 1970 to provide that IRS classifications be accepted to support the eligibility of certain types of organizations for reduced rates, provided that there was no evidence of disqualification. For other types of organizations, however, the Department did not accept IRS classifications as a basis for determining the ineligibility of organizations for reduced rates. (See p. 12.)

RECOMMENDATIONS OR SUGGESTIONS

The Postal Service should review the eligibility of nonprofit organizations presently authorized to mail at reduced rates and should revoke, as soon as practicable, the reduced-rate privileges of organizations that are not entitled to such authorizations. The Postal Service should review also the implementation of its new guidelines, to determine whether they are being applied effectively and consistently by the postal services centers in determining organizations' eligibility to mail at reduced rates. (See p. 26.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Postmaster General told GAO that the Office of Mail Classification had established definitions of the eight categories of organizations named in the law that are eligible for reduced third-class postage rates. He also said that similar definitions would be adopted for the categories of organizations eligible for the special second-class rate. According to the Postmaster General, the definitions disseminated to postal services centers will provide guidelines more in keeping with the intent of the Congress when it established the preferential rates and will ensure more consistent rulings among the 64 postal services centers. (See p. 25.)

As of November 1971 definitions of organizations eligible for reduced second-class rates had not been developed. The Service, however, was using the new guidelines issued for third-class rate determinations in reviewing applications for reduced second-class rates. GAO did not evaluate the implementation of the new guidelines.

In February 1972 GAO found that the 27 organizations which it had questioned at one postal services center still were authorized to mail at reduced third-class rates. At another postal services center, the authorizations of 24 of the 31 organizations GAO questioned had been canceled and the remaining seven organizations were authorized to continue mailing at the reduced third-class rates. Postal Service headquarters had not reviewed the eligibility of organizations mailing at reduced second-class rates that GAO had questioned. (See p. 26.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Postal Service is not collecting substantial revenues to which it is entitled because, in GAO's opinion, it is permitting ineligible nonprofit organizations to mail at reduced postage rates.

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CHAPTER 1

INTRODUCTION

The Postal Reorganization Act (39 U.S.C. 101) approved on August 12, 1970, abolished the Post Office Department and established the United States Postal Service as an independent establishment of the executive branch of the Government. The act rescinded all provisions of Title 39, United States Code, and enacted a revised and recodified Title 39. Sections 3626 and 3627 of Title 39, United States Code, provide that eligible nonprofit organizations may continue to mail at the reduced postage rates prescribed by former provisions of sections 4358 and 4452 of Title 39, United States Code, until such rates are revised in accordance with the provisions of the act.

The former provisions of 39 U.S.C. 4358 and 4452 provided that nonprofit religious, educational, scientific, philanthropic, agricultural, labor, veterans, or fraternal organizations qualify for reduced second- or third-class postage rates. Publications of associations of rural electric cooperatives, educational radio or television stations, and one publication of the official highway or development agency of a State would have qualified also for reduced second-class postage rates if these organizations were nonprofit organizations. The reduced rates range from 23 to 60 percent less than the regular second- and third-class postage rates.

According to postal regulations, an organization is considered as being a nonprofit organization if it is not organized for profit and if none of its net income benefits any private stockholder or individual. Second-class mail generally consists of newspapers, magazines, and other periodical publications. Third-class mail generally consists of printed matter, such as circulars.

For fiscal year 1970 the Department reported total expenditures of \$8.1 billion, of which about \$4.1 billion was categorized by the Department as attributable costs. Attributable costs are defined as (1) costs which generally vary in response to changes in volume of a class of mail or type

of service and (2) those fixed costs which are the consequence of providing a class of mail or type of service. During that year, the attributable costs of second- and third-class mail handled for nonprofit organizations (6.1 billion pieces) were \$128 million and revenues were \$75 million.

The Postal Reorganization Act provides that any new rates established by the Postal Service for nonprofit organizations be adjusted over a 10-year period, under annual increases, so that, after 10 years, the revenues from nonprofit reduced-rate mailings shall not exceed the attributable costs of such mailings.

Applications for reduced second-class postage rates are filed at local post offices and are forwarded to Postal Service headquarters where eligibility for such reduced postage rates is determined.

Applications for reduced third-class postage rates are filed at local post offices. The applications are forwarded to the postmaster at one of the 64 postal services centers designated to serve the post offices within a geographical area. The postmasters at the 64 postal services centers are responsible for reviewing and for approving or denying applications for third-class nonprofit postage rates. Applicants who are denied third-class nonprofit rates may appeal the decision to the Director, Office of Mail Classification, Washington, D.C., who has overall responsibility for administration of the nonprofit reduced-rate program.

Our review was made to evaluate the effectiveness of the Postal Service's policies for administration of the reduced-rate mailing privileges for nonprofit organizations. Our review was performed at Postal Service headquarters in Washington, D.C., and at the following five post offices: Chicago, Illinois; Indianapolis, Indiana; New York, New York; St. Louis, Missouri; and Bloomington, Indiana.

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CHAPTER 2

INELIGIBLE ORGANIZATIONS

MAILING AT REDUCED POSTAGE RATES

The Department has not collected substantial revenues to which it is entitled because it has permitted certain ineligible nonprofit organizations to mail at reduced postage rates. In our review at five post offices, we identified 115 organizations which, in our opinion, were not eligible for reduced second- or third-class postage rates. We estimated that the postage collected from these organizations on about 71.6 million pieces of mail was about \$1.5 million less than the postage which should have been collected during the 1-year period included in our review.

In our opinion the Department did not have adequate criteria for use by postal personnel to determine eligibility of nonprofit organizations for reduced postage rates, because postal regulations did not give guidance for approving or disapproving applications for reduced rates. Such guidance would include definitions, characteristics, purposes, or activities of organizations that would indicate eligibility or ineligibility for reduced postage rates.

Some of the 115 organizations were granted nonprofit mailing privileges at one or more post offices, while the same or similar organizations were denied the same privileges at other post offices.

Postal officials at the postal services centers generally agreed that the Department's criteria were not adequate for evaluating applications for reduced postage rates.

Postal officials conceded that ineligible organizations might have been afforded nonprofit mailing privileges. They also stated that they would be reluctant to revoke any permits for such privileges because many of these organizations probably had enjoyed nonprofit mailing privileges for a number of years.

LACK OF ADEQUATE CRITERIA HAS CAUSED
INCONSISTENT AND QUESTIONABLE APPROVAL
OF REDUCED POSTAGE RATES

Postal regulations in effect during our review did not define the characteristics or activities of nonprofit organizations that would make them eligible for reduced postage rates.

The postal regulations stated that organizations applying for reduced second- and third-class postage rates must submit evidence of their eligibility. The application for reduced second-class rates requires an applicant to submit evidence, such as certified copies of the organization's constitution, bylaws, charter, and articles of incorporation and information on the publications issued by the applicant. The application form for reduced third-class rates requires an applicant to submit copies of the organization's charter, constitution, bylaws, income tax exemption, publications, or similar evidence to establish eligibility. On each application an applicant must indicate that the organization is nonprofit and that none of the net income inures to the benefit of any private stockholder or individual.

The postal regulations provided that certain types of organizations, such as business leagues, citizens' and civic improvement associations, and social clubs, were not eligible for reduced third-class postage rates. The regulations, however, did not give guidance, such as definitions, characteristics, purposes, or activities of organizations, for use by postal personnel in reviewing applications for reduced postage rates. Postal regulations were silent concerning the types of organizations which were not eligible for reduced second-class postage rates.

Washington headquarters forwarded to the 64 postal services centers copies of certain rulings by the headquarters staff on applications for reduced third-class rates, and these rulings were intended to serve as guidelines to the centers in approving or disapproving applications for reduced rates. The rulings, however, generally did not explain the basis for the determinations therein. They consisted of a summary of the organization's purposes and activities, as reported by the applicant organization, and

concluded, for example, that the information submitted by an organization showed that its primary purpose was not educational and that the organization was not eligible for reduced rates.

We believe that, because the rulings did not specify the criteria for the determination, that is, the factors considered in determining the organization's primary purpose and its eligibility, the rulings were more informational in character than instructional.

We were informed by a postal official that the Department required follow-up reviews to ensure the continuing eligibility of organizations which had been authorized non-profit mailing privileges. Organizations authorized second-class nonprofit mailing privileges must file annual Statements of Ownership in which they certify that their purposes, activities, and Internal Revenue Service tax exempt status have not changed. Organizations authorized third-class nonprofit mailing privileges certify, when paying their \$30 annual bulk mailing fee, that their purposes, activities, and IRS tax exempt status have not changed.

Since postal regulations neither defined the characteristics nor provided data on the purposes and activities that organizations must have to be eligible for reduced rates, we asked postal officials what criteria were used by postal personnel in making such determinations. The postal officials stated that a nonprofit organization must demonstrate that its primary purpose and activities come under one of the categories cited in the law (religious, educational, scientific, philanthropic, agricultural, labor, veterans, or fraternal) to be eligible for reduced postage rates.

Many nonprofit organizations have characteristics, purposes, and activities which qualify them for reduced postage rates. The distinction is not clear in the case of other organizations that engage in a number of diversified activities, some of which would indicate a qualification for reduced postage rates and others which would not. We believe that, because specific criteria were not available to assist postal employees to determine the primary purposes of organizations, inconsistent approval and disapproval actions occurred.

We noted that 21 organizations had been granted reduced third-class postage rates at one or more post offices and that the same or similar organizations were denied such postage rates at other post offices. Seven organizations had been granted reduced second-class postage rates as educational or scientific organizations but had been denied reduced third-class postage rates.

As a specific illustration, an organization that had been mailing at the reduced third-class postage rate as an educational organization for 9 years applied at a post office in a neighboring city for reduced third-class mailing privileges, and the application was approved. The permits at both post offices were revoked 2 years after the approval, because the Department informed the local postmasters that the organization was a business league. About a month later the organization's reduced rate privileges were restored. Department records did not show the basis for the reinstatement.

IRS classifies the organization as a business league. Details of this case are presented in appendix I.

In another case an organization that had been granted reduced second-class postage rates by the Department in 1958 was denied third-class reduced rates at the Chicago Post Office in 1965 and again in 1968 because it was considered to be a business league.

IRS makes determinations concerning the nonprofit status of organizations for income tax purposes. Section 501 of Title 26, United States Code, provides, in part, that such organizations as nonprofit religious, educational, scientific, charitable, agricultural, labor, veterans, and fraternal beneficiary societies be exempt from paying Federal income taxes. These eight types of organizations are essentially the same as the eight types of organizations that, under the former provisions of 39 U.S.C. 4358 and 4452, are eligible for reduced second- and third-class postage rates.

When an organization files an application with IRS to establish its exemption from Federal income tax, it must submit evidence--such as articles of incorporation; trust instruments, or other enabling instruments; copies of bylaws;

and a financial statement of receipts and expenditures, together with a complete statement of assets and liabilities. IRS has established detailed guidelines and instructions for use by its employees in determining the primary purposes and activities of organizations applying for Federal tax exemption.

For example, the IRS criteria for civic leagues, social welfare organizations, and local associations of employees is stated as follows:

"(1) Section 501(c) (4) of the Code grants exemption to:

"Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

"(2) From the foregoing definition it is apparent that section 501(c) (4) embraces two general classifications, organizations promoting social welfare and local associations of employees whose earnings are devoted to charitable, educational, or recreational purposes."

The criteria then describe in some length, with examples, activities of social welfare organizations in terms of services to the community and services to members; organizations supported by Government programs in relief of social and economic conditions; the concepts of social welfare and charity; local employees associations; and nonexempt activities, such as participation in political campaigns. The criteria also contain cross-references to supporting court rulings, IRS decisions, and regulations.

IRS also analyzes sources of income to determine whether they are acceptable, such as gifts, for tax exempt organizations or prohibited, such as profit from sales in a student bookstore. IRS analyzes the purposes for which income is

distributed, i.e., whether it is distributed to an exempt organization or for an exempt purpose or whether, through unreasonable compensation or dividends, it is distributed to the inurement of certain individuals.

IRS also conducts periodic audits of the annual financial returns required to be filed by nonprofit organizations to determine, among other things, whether there has been any change in the primary purposes and activities or in the nonprofit status of the organizations.

Because IRS made thorough examinations into organizations' purposes and activities before classifying organizations by type and because it had more specific criteria than the Postal Service on which to base its classifications, we concluded that the Postal Service should consider IRS classifications when determining whether to approve or disapprove organizations' applications to mail at reduced rates. In our opinion the use of IRS's classifications of organizations should help reduce inconsistencies within the Postal Service in granting eligibility for reduced rates.

After we discussed our preliminary findings with a Post Office Department headquarters official, the Department revised postal regulations in January 1970 to authorize the granting of reduced third-class postage rates for nonprofit religious, educational, scientific, philanthropic, and fraternal organizations whenever IRS classified the organizations in these categories, provided that there was no evidence of disqualification. Department officials informed us that reduced second-class postage rates for these types of organizations also were approved on the basis of IRS classifications. They stated that postal regulations were not revised to specifically state this policy because headquarters officials approved reduced-rate, second-class mailing privileges and because these officials knew that IRS classifications were acceptable for establishing eligibility for reduced-rate, second-class mailing privileges.

The Department's revised regulations, however, did not provide that IRS classifications of organizations as business leagues, citizens' and civic improvement associations, and social clubs would be considered to support the ineligibility of such organizations for reduced postage rates. In

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our opinion such IRS classifications should have been considered because IRS had more information upon which to base its eligibility decisions and because its criteria for evaluating organizations' applications provided more specific guidance to its employees than did the Postal Service criteria in determining the primary purpose and activities of organizations.

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REVENUE LOSSES RESULTING FROM
INELIGIBLE ORGANIZATIONS MAILING
AT REDUCED POSTAGE RATES

At the five post offices included in our review, about 10,400 organizations had been granted reduced second- or third-class mailing privileges. We scanned listings of these organizations and selected 1,135 organizations for review. These organizations were selected because it seemed to us, on the basis of their names, that their eligibility for reduced rates might be questionable. For example, a local gymnastic society mailing at reduced third-class rates was selected for review because it was questionable whether a gymnastic society might qualify as a religious, educational, scientific, philanthropic, agricultural, labor, or veterans organization.

We concluded that 115 of the 1,135 nonprofit organizations--84 business leagues, 21 citizens' and civic improvement associations, and 10 social clubs--were not eligible for reduced rates. The 115 organizations had been classified by IRS as nonprofit business leagues, citizens' and civic improvement associations, and social clubs. The data in the IRS files which we reviewed showed that the primary purpose and activities of such organizations were business leagues, social clubs, and citizens' and civic improvement associations, as discussed below. Under postal laws and regulations, business leagues, citizens' and civic improvement associations and social clubs do not qualify for reduced postage rates.

We estimated that the Department undercharged postage of \$1.5 million during the 1-year period included in our review because it handled 71.6 million pieces of mail for the 115 organizations at reduced second- and third-class postage rates.

Business leagues

Black's Law Dictionary, Fourth Edition, defines a business league as an association of persons with a common business interest. IRS defines a business league as a group of persons who unite together to promote or improve a common business or professional interest.

At the five post offices, we found that the Department granted reduced second- or third-class postage rates to 84 nonprofit organizations that IRS had classified as business leagues. We estimated that the Department undercharged postage of \$1.3 million during the 1-year period covered by our review because it handled 65.1 million pieces of mail for 64 of these organizations at reduced second- or third-class postage rates. The remaining 20 organizations had no mailings during the period. The Department's classifications of the business leagues which were granted reduced second- and third-class postage rates follow.

<u>Organizational classification</u>	<u>Number approved</u>	<u>Number who mailed</u>	<u>1-year period</u>	
			<u>Pieces mailed (000 omitted)</u>	<u>Postage under-charged</u>
Philanthropic	1	-	-	\$ -
Educational	35	28	31,098	645,136
Scientific	24	19	3,299	79,311
Labor	3	2	56	490
Combination of two or more of above	16	10	30,367	567,268
Not shown	<u>5</u>	<u>5</u>	<u>325</u>	<u>4,832</u>
Total	<u>84</u>	<u>64</u>	<u>65,145</u>	<u>\$1,297,037</u>

The following case illustrates the differences in classification between the Department and IRS. The Department granted an organization reduced third-class postage rates in June 1963 because it was considered to be an educational organization. Data submitted with the application contained a statement that the purpose of the organization was:

"To constitute and perpetuate an organization of persons qualified to engage in and concerned with the development and advancement of the art, science, and the profession of ***."

Data submitted to IRS by the nonprofit organization in 1958, which included the organization's articles of incorporation and financial data, showed that the primary purpose of the organization was to promote the interest of a certain

profession, and IRS classified this organization as a business league. Since the primary purpose of this organization was not related to education, we believe that the Department should not have considered this organization to be an educational organization.

As of October 1969 IRS still classified the organization as a business league. The Department collected postage of \$150 from this organization during calendar year 1968 for handling 10,171 pieces of mail at reduced third-class postage rates. Postage at the regular third-class rate would have been \$370.

Social clubs

Social clubs are not eligible for reduced postage rates. Black's Law Dictionary, Fourth Edition, defines a social club as an organization whose social features are a material part of its activities and are necessary to its existence and not merely incidental. IRS defines social clubs as a group of persons united together for pleasure, recreation, or other similar purposes.

The Department granted reduced second- and third-class postage rates to 10 nonprofit organizations that IRS classified as social clubs.

We estimated that the Department undercharged postage of \$1,300 during the period of our review because it handled 169,000 pieces of mail for 5 of the 10 organizations at reduced second- and third-class postage rates. The remaining 5 organizations had no mailings during the period. The Department's classifications of the organizations which we considered to be social clubs and which were authorized reduced second- and third-class postage rates are shown below.

<u>Organizational classification</u>	<u>Number approved</u>	<u>Number who mailed</u>	<u>1-year period</u>	
			<u>Pieces mailed (000 omitted)</u>	<u>Postage under-charged</u>
Religious	3	2	13	\$ 101
Educational	6	2	154	1,159
Educational and philanthropic	<u>1</u>	<u>1</u>	<u>2</u>	<u>40</u>
Total	<u>10</u>	<u>5</u>	<u>169</u>	<u>\$1,300</u>

Citizens' and civic improvement associations

Citizens' and civic improvement associations are not eligible for reduced postage rates. Although Department regulations do not provide postal personnel with definitions of, and guidelines on, the characteristics, purposes, or activities of citizens' and civic improvement associations, the regulations do specify that nonprofit service organizations, such as the Lions, Rotary, and Kiwanis, are not eligible for reduced third-class postage rates. Citizens' and civic improvement associations, or civic leagues as defined by IRS, are organizations formed to promote the common good and general welfare of a community through civic betterment and social improvement.

The Department granted second- and third-class postage rates to 21 nonprofit organizations which, in our opinion, had all the characteristics and activities normally associated with civic leagues or citizens' and civic improvement associations. IRS classified these organizations as civic leagues.

We estimate that the Department undercharged postage of \$165,709 during the 1-year period covered by our review because it handled 6.3 million pieces of mail for 8 of these organizations at reduced second- and third-class postage rates. The remaining 13 organizations had no mailings during the period. The Department's classifications of the citizens' and civic improvement associations that were authorized reduced second- and third-class postage rates are shown below.

<u>Organizational classification</u>	<u>Number approved</u>	<u>Number who mailed</u>	<u>1-year period</u>	
			<u>Pieces mailed (000 omitted)</u>	<u>Postage undercharged</u>
Religious	1	-	-	\$ -
Educational	8	4	1,142	11,650
Scientific	3	3	5,167	153,945
Philanthropic	4	-	-	-
Labor	1	-	-	-
Combination of two or more of above	<u>4</u>	<u>1</u>	<u>5</u>	<u>114</u>
Total	<u>21</u>	<u>8</u>	<u>6,314</u>	<u>\$165,709</u>

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The Internal Audit Division, Bureau of Chief Postal Inspector, issued an internal audit report in March 1970 on third-class mail procedures in the Atlanta Postal Region. The audit was performed in six post offices in Georgia and North Carolina. The report questioned the eligibility of 44 organizations authorized reduced third-class postage rates at five of the post offices and recommended that the postmasters redetermine the eligibility of these organizations for reduced rates. Many of the organizations questioned were similar to the 115 organizations discussed in this report.

In response to the internal audit recommendations, the Atlanta Acting Regional Director stated that, on March 16, 1970, the five postmasters were furnished with a list of the organizations identified during the audit as having questionable or inadequate documentation to support their eligibility for reduced postage rates. The postmasters were instructed to review or to obtain support to make determinations on the eligibility of the organizations and to report to the Atlanta Regional Office on actions taken.

The reports submitted showed that, as of April 1971, one of the 44 organizations had its reduced-rate mailing privileges revoked. For the remaining 43 organizations, the postmasters reported that (1) adequate documentation was on hand to support the organizations' nonprofit eligibility, (2) the nonprofit privilege had been canceled because the organization had moved to a new address or was no longer using the privilege, or (3) the case had been referred to the postal services center for its review.

COMMENTS OF LOCAL POSTAL EMPLOYEES

Postal officials at the postal services centers indicated that, since applications for reduced-rate mailing privileges for second-class mail were approved or disapproved at Department headquarters, they could not comment on the validity of such actions.

Concerning the organizations mailing at reduced third-class rates that we believe should have been considered to

be ineligible for such mailing privileges, officials at the postal services centers said that the approval of these organizations was consistent with (1) the Department's policy for determining eligibility, (2) precedents set by Department headquarters officials in determining eligibility for reduced second-class rates, or (3) precedents set in cases involving third-class, reduced-rate rulings by Department headquarters when decisions of postal services centers were appealed by applicants to Department headquarters.

An official of a postal services center told us that he had approved some organizations whose eligibility we had questioned because he followed the precedents established by Department headquarters and that it would be unfair to deny reduced postage rate privileges to organizations similar to those previously approved.

Postal officials at the postal services centers generally agreed that the Department's postal regulations in effect during our review did not contain adequate criteria for use by postal personnel in evaluating applications for reduced postage rates. These officials advised us that they were of the opinion that use of IRS classifications of organizations by type as the basis for granting reduced postage rates would be better than the Department's existing criteria because IRS had more data available to determine the purposes and activities of nonprofit organizations.

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CHAPTER 3

AGENCY COMMENTS AND

GAO EVALUATION AND RECOMMENDATIONS

The Postmaster General, in a letter dated July 7, 1971, commented on our proposals that the Postal Service (1) adopt IRS classifications of organizations into the various types of nonprofit organizations as a basis of Postal Service policy for determining organizations' eligibility or ineligibility for reduced rates and (2) redetermine the eligibility of organizations authorized to mail at reduced rates, using IRS determinations as the basis for eligibility decisions. (See app. II.) The Postmaster General's comments and our evaluation follow.

The Postmaster General said that granting or terminating reduced postage rates solely on the basis of IRS determinations effectively would transfer the responsibility of deciding whether a particular organization was entitled to reduced postage rates from the Postal Service, in which the responsibility was vested by the Congress, to IRS, which made its decisions on the basis of the wording of the Internal Revenue Code. He stated that, since the responsibility of deciding whether reduced postage rates were to be granted was vested by law in the Postal Service, the Postal Service legally could not take the position that it automatically, and without any independent consideration, would accept and act upon IRS determinations.

Sections 3626 and 3627 of Title 39, United States Code, provide that eligible nonprofit organizations may continue to mail at the reduced postage rates prescribed by the former provisions of 39 U.S.C. 4358 and 4452--until such rates are revised in accordance with the provisions of the act. The provisions of 39 U.S.C. 4358(h) concerning second-class mail provided that:

"The publisher of a *** publication of a nonprofit organization, before being entitled to the

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rates for the publications, shall furnish such proof of qualifications as the Postmaster General prescribes."

Similarly the provisions of 39 U.S.C. 4452(d) concerning third-class mail provided that, to be eligible for the reduced nonprofit rates, an organization or association must furnish proof of its qualifications to the Postmaster General.

Although it seems clear that the Postmaster General is charged with the responsibility for determining eligibility of organizations for reduced postage rates, the law placed no requirements or restrictions upon the basis or evidence that the Postmaster General might accept to determine eligibility for the reduced rates. We believe that the Postmaster General may accept IRS classifications of organizations by type of organization as evidence in establishing whether organizations are eligible for reduced nonprofit rates.

The Postmaster General referred to a report of the Senate Committee on Post Office and Civil Service, dated November 21, 1967 (S. Rept. 801, 90th Cong., 1st sess.), which stated, in part:

"That an organization qualifies as 'nonprofit' for internal revenue purposes has nothing to do with its being classified as a 'nonprofit' under the statutory requirements of postal law."

We recognize that an organization should not qualify for reduced postage rates solely because IRS has classified the applicant organization as a nonprofit organization. The controlling factor in determining an organization's eligibility for reduced postage rates is the type of nonprofit organization it is.

According to postal law, to be eligible for reduced second- or third-class postage rates, a nonprofit organization must be one of the following types of organizations: religious, educational, scientific, philanthropic, agricultural, labor, veterans, or fraternal. IRS recognizes certain types of nonprofit organizations, including those listed above, as being exempt from Federal income tax. IRS

recognizes also certain other types of nonprofit organizations which are not eligible for reduced postal rates, such as civic leagues and recreation clubs, as being nonprofit organizations exempt from Federal income tax. We believe that the statement in Senate Report 801, quoted above, recognizes that organizations should not be considered eligible for reduced rates solely because IRS has determined those organizations to be nonprofit organizations.

Our proposal was not intended to suggest that the Postal Service approve reduced postage rates solely because IRS classified organizations as nonprofit. Rather, we were proposing that the Postal Service consider the IRS classifications of organizations by their type in determining organizations' eligibility for reduced postal rates.

We also note that, in Senate Report 801, the Senate Committee on Post Office and Civil Service expressed the following views.

"The committee is concerned about the substantial growth that has occurred in this category of mail [nonprofit rate mailings] and by the size of the public service dollar loss attributable to it. From 1959 to 1966, the number of pieces in this category increased from 1.5 to 2.3 billion, a 53-percent increase as compared with the 14-percent increase for all other second-class mail. The public service dollar loss for this one category of mail is estimated to be \$126 million for 1968. Cost coverage is only 7 percent at the present time and will rise only to 9 percent after the full increases provided in this bill take effect.

"The committee believes that a large part of the growth in this category of mail has occurred as a result of the illegitimate use of this preferred postage rate by many organizations with commercial motives masquerading as nonprofit organizations. That an organization qualifies as 'nonprofit' for internal revenue purposes has nothing to do with its being classified as a 'nonprofit' under the statutory requirements of postal law. The

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committee directs the Post Office Department to undertake immediately a thorough review of the more than 8,000 various nonprofit associations utilizing this rate. The Department should withdraw the second- and third-class permits of those who fail to qualify. The committee would also welcome recommendations from the Department on reformation of the existing law with respect to the types of organizations to be afforded this preference. More precise conditions than those in the present statute may need to be imposed in order to eliminate those organizations whose activities do not warrant this large subsidization by the taxpayer.

"At the same time, the Department should make every effort to ensure that organizations legally entitled to the preferential rate are treated equally at all post offices. A central coordination of certification to ensure that congressional policy and departmental implementation are being followed would eliminate discriminatory practices that justifiably upset and mystify some users who mail at the preferential rate at one office and are denied the preference at another office."
(Underscoring supplied.)

A Department official advised us that the Department had not made a review of all mailers using reduced rates to weed out ineligible organizations nor had the Department made any recommendations to the Congress on reforming existing law concerning eligibility for reduced rates.

The Postmaster General acknowledged that, at the suggestion of the General Accounting Office, the Postal Service had revised its regulations in January 1970 by adding section 134.52 to its Postal Service Manual, which read:

"When an organization submits proof that it has been granted income tax exemption under Title 26, United States Code, section 501 (c) (3), as a religious, educational, scientific, or philanthropic (charitable) organization, or under

section 501 (c) (8), as a fraternal organization, it will be considered as qualifying for the special third-class rate unless the available evidence discloses some disqualification."

The Postmaster General said that recent studies revealed that section 134.52 of the Postal Service Manual was being interpreted and administered inconsistently. He said also that many postmasters at postal services centers interpreted this regulation to provide blanket approval of all applications which included evidence that the organization had been exempted from payment of Federal income taxes under 26 U.S.C. 501(c)(3) and section 501(c)(8) of the Internal Revenue Code.

According to the Postmaster General, the Office of Mail Classification, in reviewing applications forwarded to that office for rulings, has noted the great dissimilarity in IRS requirements and criteria and those previously used by the Postal Service in making determinations for preferential postal rates. He said that a marked increase was noted in the number of applications which were approved incorrectly or inconsistently by postal services centers and that the Postal Service was considering deleting section 134.52 of the Postal Service Manual.

If the Postal Service Manual is being misinterpreted by postal employees, we believe that the manual should be clarified or that sufficient explanations should be made to postal employees to provide reasonable assurance for obtaining consistent implementation of the Postal Service's policy.

The Postmaster General said that the Postal Service was cognizant of the fact that improper rate applications on large second- and third-class mailings could result in major revenue losses and that the Postal Service intended to make every effort to correct inconsistencies and irregularities relating to the granting of authorizations to mail at the reduced second- and third-class rates. He added that the Postal Service intended to accomplish this by using the Postal Service interpretation and administration of the postal statutes.

The Postmaster General said also that, in an effort to clarify the meaning and standardize the administration of the applicable postal regulations, the Office of Mail Classification had done extensive research to establish definitions of the eight categories of organizations named in the law as eligible for reduced third-class rates. He said further that, with the concurrence of the Law Department, the definitions were disseminated to all 64 postal services centers and that similar definitions would be adopted for the categories of organizations named in former section 4358 of Title 39, United States Code, which established the reduced second-class rate for the several categories named.

According to the Postmaster General, the definitions disseminated to postal services centers will provide guidelines more in keeping with the intent of the Congress when it established the preferential rates, will be consistent with the directive in Senate Report 801 (Pub. L. 90-206), and will ensure more consistent rulings among the 64 postal services centers.

A postal official advised us that, as of November 1971, definitions of organizations eligible for reduced second-class rates had not been developed. The Service was using, however, the new guidelines issued for third-class rate determinations in reviewing applications for reduced second-class rates. Since the Postal Service's new guidelines were disseminated to the postal services centers on May 24, 1971, after our audit work had been completed, we did not evaluate the implementation of the new guidelines.

The guidelines stated that it was likely that some organizations had been granted reduced rates in error because of failures to consider all evidence thoroughly. The guidelines pointed out that it was necessary to revoke, at the earliest practicable moment, any authorizations which had been granted in error. Applicants for reduced third-class rates are required to cite on the application form the IRS classification of their organization, e.g., business league, social club, or religious.

In February 1972 we contacted officials at two of the postal services centers included in our review to ascertain whether the organizations which we had concluded were ineligible during our review still were authorized to mail at the reduced third-class rates. An official of one postal services center said that the 31 organizations which we had questioned at the postal services center had been instructed by the postal services center to submit new applications for the reduced third-class rates. The postal services center canceled the reduced third-class privileges of 24 organizations and authorized the remaining seven organizations to continue mailing at the reduced third-class rates.

An official of the other postal services center advised us that the 27 organizations we had questioned during our review still were authorized to mail at reduced third-class rates. (We had discussed the 27 organizations with a postal services center official in June 1970. The official commented on two of the organizations and stated that they should not have been authorized to mail at the reduced third-class rates.) The official stated that the postal services center had not reviewed the eligibility of the 27 organizations after the issuance of the new guidelines and, in general, was not reviewing the eligibility of organizations that had been granted reduced third-class rates in the past because of manpower limitations.

On February 16, 1972, we were advised by officials of the Office of Rates and Classification at Postal Service headquarters that the Postal Service had not reviewed the eligibility of the nonprofit organizations mailing at the reduced second-class rates that we had questioned during our review and had not made a general review of the eligibility of other nonprofit organizations that had been granted reduced second-class rates in the past to determine whether ineligible organizations were mailing at the reduced rates.

RECOMMENDATIONS TO THE POSTMASTER GENERAL

We recommend that the Postal Service review the eligibility of nonprofit organizations presently authorized to mail at reduced rates and revoke, as soon as practicable, the reduced rate privileges of organizations that are not entitled to such authorizations. We recommend also that

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the Postal Service review the implementation of its new guidelines to determine whether they are being applied effectively and consistently by the postal services centers in determining organizations' eligibility to mail at reduced rates.

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CHAPTER 4

SCOPE OF REVIEW

Our review was performed at Postal Service headquarters in Washington, D.C.; the postal services centers in Chicago, Indianapolis, New York, and St. Louis; and the post office in Bloomington.

Our review was directed toward an appraisal of the policies, procedures, and controls of the Postal Service in determining the eligibility of organizations for reduced second- and third-class postage rates.

Our review covered the mailings at the Indianapolis, Bloomington, Chicago, New York, and St. Louis Post Offices. The five post offices had granted reduced second- or third-class postage rates to about 10,400 organizations. For those organizations which we considered ineligible for reduced rates, we also covered the mailings of second-class mail at other post offices throughout the United States. For the ineligible organizations at Indianapolis and Bloomington, our review covered calendar year 1968, and, for the ineligible organizations at Chicago, New York, and St. Louis, our review covered calendar year 1969.

We examined legislation, postal regulations, internal audit reports, and other pertinent records relating to reduced second- and third-class postage rates. We examined also legislation, regulations, and pertinent documents relating to Federal income tax exemptions granted to nonprofit organizations. We reviewed selected IRS records concerning certain nonprofit organizations and interviewed Postal Service and IRS personnel.

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CHRONOLOGY OF DEPARTMENT ACTIONS
CONCERNING AN ORGANIZATION THAT WAS AUTHORIZED
REDUCED THIRD-CLASS POSTAGE RATES

- December 19,
1951 An organization filed an application, as an educational institution, at a post office for reduced third-class postage rates. The organization stated that it was organized to advance the understanding of the principles, policies, practices, and purposes of modern management and of the methods of creating and maintaining satisfactory relations in commerce and industry.
- February 27,
1952 The application for reduced third-class postage rates was denied by the Post Office Department. No specific reason was given for the denial but the Department stated that:
- "*** it does not appear that the functions of your organization entitle it to be regarded as an institution of learning or similar organization ***."
- September 16,
1955 The organization reapplied at the same post office for reduced third-class postage rates as an educational organization.
- October 20,
1955 The Department granted the organization reduced third-class postage rates on the basis that it qualified as a nonprofit educational organization. The files did not show the reason for the approval or that there had been a change in the functions or purposes of the organization since the Department's denial of reduced postage rates in February 1952.
- May 11, 1964 The organization was granted reduced third-class postage rates by the postmaster at a

APPENDIX I

second post office on the basis that it qualified as an educational organization.

- May 4, 1966 The Department advised the postmaster at the second post office that his approval of the application was erroneous since IRS had classified the organization as a business league.
- June 2, 1966 The Department instructed the postmasters of both post offices to revoke the organization's authorizations for reduced third-class postage rates since it had not been established that the organization was an educational organization.
- June 29, 1966 The organization acknowledged receipt of the notice of revocation and advised the postmaster that it was appealing the revocation.
- July 11, 1966 The Department advised both postmasters that the revocation was rescinded and the organization again was granted reduced third-class postage rates. The Department's records did not show the basis for the reinstatement of this organization at the two post offices. IRS, however, classifies the organization as a business league, which is not eligible for reduced rates under postal regulations.

Since July 1966 the organization has been allowed to mail at reduced postage rates. This organization mailed about 18.1 million pieces at reduced third-class rates during calendar year 1969. The postage collected at the reduced third-class rates amounted to about \$261,000. Postage at the regular third-class rates would have been \$660,000--a difference of \$399,000.

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THE POSTMASTER GENERAL
Washington, DC 20260

July 7, 1971

Dear Mr. Neuwirth:

We appreciate the opportunity to review and comment on your proposed report to the Congress entitled "Need to Revise the Policy for Determining Nonprofit Organizations' Eligibility for Reduced Postage Rates."

Your report recommends that the Postal Service (1) adopt Internal Revenue Service's determinations to determine organizations' eligibility for reduced rates, and (2) redetermine the eligibility (or ineligibility) of organizations now authorized to mail at reduced rates, using IRS determinations as the basis for eligibility decisions.

The granting or termination of reduced postage rates based solely upon the IRS determination would effectively transfer the responsibility of deciding whether a particular organization is entitled to reduced postage rates from the Postal Service in which it has been vested by the Congress to the IRS which makes its decisions based on the wording of the Internal Revenue Code. Since the responsibility of deciding whether reduced postage rates are to be granted is vested by law in the Postal Service, we do not believe that the Postal Service can legally take the position that it will automatically and without any independent consideration, accept and act upon the IRS determination.

Senate Report No. 801, accompanying H.R. 7977, 90th Congress, which, upon enactment, became Public Law 90-206, stated in part: "That an organization qualifies as 'nonprofit' for internal revenue purposes has nothing to do with its being classified as a 'nonprofit' under the statutory requirements of postal law."

Sections 4358 and 4452 of Title 39, United States Code, which establish special reduced second- and third-class rates of postage for the categories of nonprofit organizations named, are silent concerning

APPENDIX II

definitions, characteristics, purposes or activities of organizations which would indicate eligibility or ineligibility for reduced postage rates. The legislative history of the Acts is likewise silent in this regard. The postal regulations implementing the law also have not included definitions, characteristics, purposes or activities. Since the law in Title 39, U.S.C., section 4452(d) was enacted, the Postmaster General has delegated authority for action on applications to mail at the special bulk third-class rate alternately to the Office of Mail Classification, the local postmaster, and to the postmasters at the 64 Postal Service Centers. This delegation has naturally resulted in some disparity in rulings. Presently, the applications are processed and ruled on at Postal Service Centers, and the Office of Mail Classification acts on any appeals submitted and answers inquiries from Postal Service Centers concerning qualification, etc.

As revealed in your report (page 9), the Postal Service, at the suggestion of the General Accounting Office, revised the regulations in January 1970, adding section 134.52, Postal Service Manual, which reads:

"When an organization submits proof that it has been granted income tax exemption under Title 26, United States Code, section 501(c) (3), as a religious, educational, scientific, or philanthropic (charitable) organization, or under section 501 (c) (8), as a fraternal organization, it will be considered as qualifying for the special third-class rate unless the available evidence discloses some disqualification."

Recent studies have revealed that section 134.52, Postal Service Manual, is being inconsistently interpreted and administered. Many postmasters at Postal Service Centers have interpreted this regulation to provide for blanket approval of all applications which include evidence the organization has been exempted from payment of Federal income taxes under Title 26, U.S.C., section 501(c) (3) and section 501(c) (8) of the Internal Revenue Code.

The Office of Mail Classification, in reviewing applications forwarded to that Office for rulings, has noted the great dissimilarity in Internal Revenue's requirements and criteria and those previously used in making determination for the preferential postal rates. A marked

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increase has been noted in the number of applications which have been incorrectly or inconsistently approved by Postal Service Centers. The Postal Service is now considering deleting section 134.52, Postal Service Manual.

The Office of Mail Classification in an effort to clarify the meaning and standardize the administration of section 134.52, Postal Service Manual, has done extensive research in order to establish definitions of the eight categories of organizations named in the law. With the concurrence of the Law Department, the definitions are currently being disseminated to all of the 64 Postal Service Centers. Similar definitions will be adopted for the categories of organizations named in section 4358 of Title 39, U.S.C., which establishes the special second-class rate for the several categories named.

The definitions being disseminated to Postal Service Centers will provide guidelines more in keeping with the intent of the Congress when it established the preferential rates and will also be consistent with the directive in Senate Report No. 801 (P.L. 90-206). These definitions will also assure more consistent rulings among the 64 Postal Service Centers.

The Postal Service is cognizant of the fact that improper rate applications on large second- and third-class mailings can result in major revenue losses. We intend to make every effort to correct inconsistencies and irregularities relating to the granting of authorizations to mail at the special reduced second- and third-class rates. We propose, however, to accomplish this using the Postal Service's interpretation and administration of the postal statutes.

Sincerely,



Winton M. Blount

Mr. Max A. Neuwirth
Associate Director, Civil Division
U. S. General Accounting Office
Washington, D. C. 20548

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APPENDIX III

PRINCIPAL MANAGEMENT OFFICIALS OF
 THE UNITED STATES POSTAL SERVICE
 RESPONSIBLE FOR THE ACTIVITIES
 DISCUSSED IN THIS REPORT

	Tenure of office	
	<u>From</u>	<u>To</u>
POSTMASTER GENERAL:		
Elmer T. Klassen	Jan. 1972	Present
Merrill A. Hayden (acting)	Oct. 1971	Dec. 1971
Winton M. Blount	Jan. 1969	Oct. 1971
W. Marvin Watson	Apr. 1968	Jan. 1969
Lawrence F. O'Brien	Nov. 1965	Apr. 1968
DEPUTY POSTMASTER GENERAL:		
Merrill A. Hayden	Sept. 1971	Present
Vacant	Jan. 1971	Sept. 1971
Elmer T. Klassen	Feb. 1969	Jan. 1971
Federick C. Belen	Feb. 1964	Jan. 1969
ASSISTANT POSTMASTER GENERAL, BUREAU OF FINANCE AND ADMIN- ISTRATION (note a):		
James W. Hargrove	Feb. 1969	Aug. 1971
ASSISTANT POSTMASTER GENERAL, BUREAU OF OPERATIONS (note a):		
Frank J. Nunlist	Apr. 1969	June 1971
Vacant	Dec. 1968	Apr. 1969
William M. McMillan	Feb. 1964	Dec. 1968

^aResponsibility for administration of reduced second- and third-class postage rates was transferred from the Bureau of Operations to the Bureau of Finance and Administration in August 1969. Effective July 1, 1971, the responsibilities of the Bureau of Finance and Administration were transferred to the Senior Assistant Postmaster General, Support Group.

Copies of this report are available from the U. S. General Accounting Office, Room 6417, 441 G Street, N W., Washington, D.C., 20548.

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