

IRS Proposes New Rules Regarding Group Exemptions

June 18, 2020

The IRS allows a "central organization" to obtain a group exemption letter that permits a central organization's "subordinate organizations" to obtain recognition of their tax-exempt status without applying to the IRS. In essence, the central organization in a group exemption ruling takes on some of the oversight responsibilities the IRS would normally exercise directly with respect to the subordinate organizations—the theory being that the arrangement will lessen the administrative burden on the IRS and on the subordinate organizations participating in the group ruling. Hundreds of thousands of subordinate organizations have obtained their tax-exempt status on this basis, including many religiously-affiliated organizations such as those included in the group exemptions of the Evangelical Lutheran Church in America or the United States Conference of Catholic Bishops.

The IRS has not significantly updated the primary guidance relating to group exemptions, Revenue Procedure 80-27, for 40 years. Accordingly, it came as something of a surprise when on May 4, the IRS issued Notice 20-36, which proposes a new Revenue Procedure for the group exemption process that would—if finalized—change the requirements for organizations seeking new group exemption rulings and some of the requirements applicable to central organizations with existing group exemption letters, including the requirements for adding new subordinate organizations.

Although the Revenue Procedure described in Notice 20-36 is only a proposal, the notice states that the IRS will not accept any new requests for group exemption letters starting on June 17, 2020 and continuing until publication of the final procedure or other guidance.

The proposed Revenue Procedure would create new obligations for central and subordinate organizations and tighten many of the existing requirements. For example, the proposal would generally require all subordinate organizations to have a uniform governing instrument (such as articles of organization) and generally require all central organizations to annually submit a "detailed description of any change in the activities of its subordinate organizations" to the IRS. The proposed requirements may cause central organizations and subordinate organizations to reevaluate the pros and cons of using a group exemption.

The following is an overview of some of the more significant aspects of the proposed Revenue Procedure.



1. New Definitions of "Affiliated With," "General Supervision," and "Control"

One of the key existing requirements relating to group exemption letters is that all subordinate organizations must be "affiliated with" and under the "general supervision or control" of their central organization. The IRS has never provided guidance regarding the meaning of these terms, which Notice 20-36 acknowledges has created "confusion and created a lack of consistency for both the IRS and central organizations."

The proposed procedure aims to clarify these concepts. Rather than adopt a specific definition of "affiliated," the proposed procedure would provide that a subordinate's "affiliation" with a central organization will be "demonstrated by the entirety of the information required to be submitted" by the central organization in connection with the group ruling request.

The proposed procedure would provide that a subordinate organization is subject to a central organization's "general supervision" if the central organization (a) "annually obtains, reviews, and retains information on the subordinate organization's finances, activities, and compliance with annual [Form 990] filing requirements" and (b) informs the subordinate organization "about the requirements to maintain tax-exempt status under the appropriate paragraph of § 501(c), including [the] annual filing requirements."^[1]

A subordinate organization is subject to a central organization's "control" if (a) the central organization appoints a majority of the subordinate's officers, directors, or trustees; or (b) a majority of the subordinate organization's officers, directors, or trustees are officers, directors, or trustees of the central organization.

The proposed procedure makes clear that a subordinate organization need only be under a central organization's general supervision *or* control and that these definitions only apply to the proposed procedure and the regulation relating to central organization's ability to file group returns on behalf of the subordinate organizations participating in the group exemption. These definitions do not supply the meaning of "supervision" or "control" in other contexts.

In addition, the proposed regulations state that the new definitions of "general supervision" and "control" do not apply to existing subordinate organizations (which will continue to be governed by the current vague rules). However, a central organization that meets the proposed requirements will be deemed to exercise "general supervision" or "control," as applicable.

2. New Minimum Number of Participants in Group Ruling

If the new procedure is adopted, a central organization seeking a group exemption letter must have at least five subordinate organizations. This new requirement appears to be based purely on a desire to lessen the administrative burden on the exempt organizations division of the IRS—the IRS has calculated that its resource expenditure for processing group exemption applications is not justifiable unless it is thereby *not*



required to process at least five exemption applications for subordinate organizations that would otherwise apply on an individual basis. Smaller groups simply do not offer the administrative efficiencies that the IRS was hoping for when it initially implemented group exemption procedures.

3. One Group Exemption Ruling per Central Organization

The proposed procedure would not allow a central organization to hold more than one group exemption letter. Currently, it is permissible for a single organization to obtain multiple group rulings; however, the IRS appears to have concluded that central organizations are less likely to exercise the expected levels of supervision or control over their subordinate organizations if they are attempting to administer multiple groups at once.

4. Requirements for a Central Organization to Maintain a Group Exemption Letter

When requesting a new group exemption, the new procedure would require central organizations to submit information, including a sample copy of the subordinate organizations' uniform governing instrument, and representations indicating that the subordinate organizations meet the requirements outlined above. This requirement would apply to central organizations that add any new subordinate organizations to an existing group exemption letter.

Both the existing procedure and the proposed procedure generally require central organizations to annually submit information about their subordinate organizations to the IRS. Churches and conventions or associations of churches are exempt from this requirement. The proposed procedure would require central organizations to submit this information at least 30 days before the end of the central organization's fiscal year, rather than 90 days before the end of their fiscal year as is currently required.

The information that central organizations must submit includes a detailed description of any change in the purpose, or purposes, of its subordinate organizations as well as a detailed description of any change in the activities of its subordinate organizations. Central organizations also must identify subordinate organizations that have changed their names or addresses, new subordinate organizations, and subordinate organizations that have withdrawn or been removed from the group exemption (including due to automatic revocation of the organization due to failure to file three consecutive Form 990s). For new subordinates, the central organization must represent that the information upon which the group exemption letter was based is applicable in all material respects to the new subordinate organizations. If the central organization does not have changes to report, it must submit a statement to that effect to the IRS.

5. Summary of Key Group Exemption Requirements



The charts below summarize the key proposed and existing requirements applicable to the participants in a group exemption ruling. The proposed Revenue Procedure leaves most of the existing requirements in place, but introduces a number of modifications and new requirements.

a. Requirements for Central Organizations (COs)

b. Relationship between Central Organizations and Subordinate Organizations (SOs)

c. Requirements for Subordinate Organizations

d. Organizations Ineligible to be SOs

6. IRS Request for Comments

The IRS has requested public comments on all aspects of the proposed procedure. Comments should be submitted to the IRS by August 16, 2020.

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Please contact Lathrop GPM's Nonprofit & Tax-Exempt Organizations for more information.

[1] Inclusion in a group exemption generally does not relieve subordinate organizations of the requirement to file an annual Form 990 series return unless an exception applies (because the subordinate is a church, for example). However, a central organization may file a group return on Form 990 for two or more of its subordinate organizations.

[2] Notice 20-36 says that the IRS is considering whether to significantly tighten this restriction so that all SOs described in Code Section 509(a)(1) must be described in the same paragraph of 170(b)(1)(A), meaning that a CO could not have some SOs that were colleges and others that were hospitals, for example.