



KROKIDAS & BLUESTEIN LLP

**CLIENT ALERT**

## **IRS PROPOSES SIGNIFICANT CHANGES REGARDING GROUP EXEMPTIONS**

On May 1, 2020, the Internal Revenue Service (“IRS”) issued Notice 2020-36, proposing a new Revenue Procedure that would make substantial changes to existing IRS guidance regarding group exemptions. The proposed Revenue Procedure imposes new requirements relative to obtaining and maintaining group exemptions, and would result in increased administrative requirements for organizations that hold group exemptions.

### **Group Exemptions**

A group exemption letter is a ruling or determination issued by the IRS to a tax exempt organization, known as a central organization, which recognizes one or more additional organizations as exempt from federal income tax by virtue of being a subordinate or subordinates of the central organization. The primary advantage of a group exemption letter is that each subordinate organization is relieved from filing its own application for recognition of exemption. Subordinates may file individual IRS Forms 990, or may submit a group return that includes all of the subordinates.

In order to qualify for group exemption under existing IRS guidance, a central organization must be a non-private foundation and must establish that each subordinate organization is: (i) affiliated with the central organization; (ii) subject to the central organization’s general supervision or control; (iii) exempt under the same paragraph of Section 501(c) as all other subordinates; (iv) not a private foundation or a foreign organization; and (v) using the same accounting period as the central organization.

### **Proposed Revenue Procedure**

The proposed Revenue Procedure clarifies some of the requirements imposed under existing IRS guidance, and establishes new requirements for organizations with preexisting group exemptions as well as organizations seeking to obtain new group exemptions. Significant changes include:

#### **Administrative Requirements**

**Supplemental Group Ruling Information Deadline:** Supplemental group ruling information is information described in the Revenue Procedure that must be submitted annually to the IRS. The

deadline for filing such information is 30 days prior to the close of the central organization's annual accounting period (rather than the 90 days required under existing guidance).

**Automatic Revocation of Subordinate Organizations:** An organization that has had its exempt status automatically revoked for failure to file returns for three years is not eligible for inclusion or addition as a subordinate organization until it has obtained reinstatement of its exempt status. Additionally, if an existing subordinate organization's exempt status is automatically revoked, the central organization must notify the IRS of the revocation. If more than half of the central organization's subordinate organizations have had their exemptions automatically revoked, the group exemption may be terminated.

### **Eligibility for Inclusion or Addition to a Group Exemption**

**Uniform Governing Instrument:** All subordinate organizations must adopt a uniform governing instrument, except that 501(c)(3) subordinates may have different purpose clauses.

The uniform governing instrument rule raises a number of questions, including:

- i. Can subordinates be organized under the laws of different states? Requirements for organizational documents vary by state, and might necessitate differences in the subordinates' organizational documents.
- ii. Must all subordinates have the same organizational structure? The proposed Revenue Procedure states that "[a]ll subordinate organizations must adopt a uniform governing instrument." Different organizational structures necessarily use different organizational documents (articles of organization, trust indenture, limited liability company agreement, etc.).
- iii. How will this rule apply when a new subordinate is added to a group of preexisting subordinates? As described below, the uniform governing instrument rule will apply to subordinates formed after adoption of the final Revenue Procedure, but preexisting subordinates will be grandfathered. The proposed Revenue Procedure, however, does not explain whether a new subordinate will be permitted to have a governing instrument that conforms to that of one, but not all, of the existing subordinates.

**Definitions of "supervision" and "control":** The proposed Revenue Procedure includes definitions of "general supervision" and "control" that are not included in current IRS guidance. Under the proposed Revenue Procedure:

- i. "General supervision" is demonstrated by showing that the central organization:
  - a. Annually obtains, reviews and retains information on the subordinate's finances, activities, and compliance with its annual filing requirements; and
  - b. Transmits written information or otherwise educates the subordinate about the requirements for maintaining tax-exempt status, including annual filing requirements.

- ii. “Control” is demonstrated by showing that:
  - a. The central organization appoints a majority of the subordinate’s officers, directors or trustees; or
  - b. A majority of the subordinate’s officers, directors or trustees overlap with those of the central organization.

**Matching Requirement:** If the central organization is a Section 501(c) organization, the central organization and all subordinates must be exempt under the same paragraph of Section 501(c). If the central organization is an instrumentality or agency of a political subdivision and is not described in Section 501(c), the matching requirement only applies to the subordinates.

**Foundation Classification Requirement:** All subordinates must be classified as non-private foundations under the same paragraph of Section 509(a), but organizations classified as publicly supported under Sections 509(a)(1) and 509(a)(2) will be considered equivalent.

**Qualification:** Subordinate organizations must be organized in the U.S., but may operate in a foreign country. Additionally, the following types of organizations are not eligible for inclusion or addition as subordinate organizations: (i) private foundations; (ii) Type III supporting organizations; and (iii) qualified nonprofit health insurance issuers.

**Number of Subordinates:** In order to apply for a group exemption, the group must include a minimum of five subordinates. At least one subordinate must exist in order to maintain a group exemption.

**Number of Group Exemptions:** A central organization may hold only one group exemption. Central organizations that received more than one group exemption under prior guidance must decide which exemption to retain.

### **Transition Period and Grandfathering**

The new requirements set forth in the proposed Revenue Procedure will apply to all group exemption letters requested, and all new subordinates added to preexisting group exemptions, after the date that the final Revenue Procedure is published. For organizations with preexisting group exemptions, most of the new requirements will only become applicable after a transition period, although a few rules are considered “grandfathered” for preexisting subordinates under the prior rules applicable to group exemptions.

**“Grandfathered” Rules for Preexisting Subordinates:** Preexisting subordinates are grandfathered under certain provisions of the prior rules. Preexisting subordinates:

- i. Must all be described under the same paragraph of Section 501(c), but not necessarily under the same paragraph as the central organization;
- ii. May be classified under any paragraph of Section 509 (including Type III supporting organizations);

- iii. May have different primary purposes; and
- iv. May have unique governing instruments.

**Transition Rule:** For all other changes to the group exemption rules, preexisting subordinates will be required to comply with the new rules within one year following publication of the final Revenue Procedure.

### **Comment Period**

The proposed Revenue Procedure is subject to a public comment period during which the IRS will receive and consider comments on all aspects of the Revenue Procedure. Comments should be submitted on or before August 16, 2020.

If you have any questions about the proposed Revenue Procedure, submission of comments in response to the proposed new requirements, or group exemption more generally, please contact Attorneys Elka Sachs, [esachs@kb-law.com](mailto:esachs@kb-law.com), or Eric Reustle, [ereustle@kb-law.com](mailto:ereustle@kb-law.com).

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