

**DESCRIPTION OF THE CHAIRMAN'S MARK OF A PROPOSAL TO
REQUIRE THE INTERNAL REVENUE SERVICE TO NOTIFY
EXEMPT ORGANIZATIONS BEFORE REVOKING EXEMPT STATUS
FOR FAILING TO FILE INFORMATION RETURNS**

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Prepared by the Staff
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INTRODUCTION

The Senate Committee on Finance has scheduled a committee markup on February 11, 2015, of a proposal to require the Internal Revenue Service to notify exempt organizations before revoking exempt status for failing to file information returns. This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Mark of a Proposal to Require the Internal Revenue Service to Notify Exempt Organizations Before Revoking Exempt Status for Failing to File Information Returns* (JCX-33-15), February 9, 2015. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

A. Require Internal Revenue Service to Notify Exempt Organizations Before Revoking Exempt Status for Failing to File Information Returns

Present Law

Applications for tax exemption

Section 501(c)(3) organizations

Section 501(c)(3)² organizations (with certain exceptions) are required to seek formal recognition of tax-exempt status by filing an application with the IRS (Form 1023 (Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code) or Form 1023-EZ (Streamlined Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code)).³ In response to the application, the IRS issues a determination letter or ruling either recognizing the applicant as tax-exempt or not. Certain organizations are not required to apply for recognition of tax-exempt status in order to qualify as tax-exempt under section 501(c)(3) but may do so. These organizations include churches, certain church-related organizations, organizations (other than private foundations) the gross receipts of which in each taxable year are normally not more than \$5,000, and organizations (other than private foundations) subordinate to another tax-exempt organization that are covered by a group exemption letter.

A favorable determination by the IRS on an application for recognition of tax-exempt status generally will be retroactive to the date that the section 501(c)(3) organization was created if it files a completed Form 1023 within 15 months of the end of the month in which it was formed.⁴ If the organization does not file Form 1023 or files a late application, it will not be treated as tax-exempt under section 501(c)(3) for any period prior to the filing of an application for recognition of tax exemption.⁵ Contributions to section 501(c)(3) organizations that are subject to the requirement that the organization apply for recognition of tax-exempt status

² All section references are to the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise noted.

³ See sec. 508(a).

⁴ Pursuant to Treas. Reg. sec. 301.9100-2(a)(2)(iv), organizations are allowed an automatic 12-month extension as long as the application for recognition of tax exemption is filed within the extended, *i.e.*, 27-month, period. The IRS also may grant an extension beyond the 27-month period if the organization is able to establish that it acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. Treas. Reg. secs. 301.9100-1 and 301.9100-3.

⁵ Treas. Reg. sec. 1.508-1(a)(1).

generally are not deductible from income, gift, or estate tax until the organization receives a determination letter from the IRS.⁶

Other section 501(c) organizations

Most other types of section 501(c) organizations – including organizations described within sections 501(c)(4) (social welfare organizations, etc.), 501(c)(5) (labor organizations, etc.), or 501(c)(6) (business leagues, etc.) – are not required to provide notice to the Secretary that they are requesting recognition of exempt status. Rather, organizations are exempt under these provisions if they satisfy the requirements applicable to such organizations. However, in order to obtain certain benefits such as public recognition of tax-exempt status, exemption from certain State taxes, and nonprofit mailing privileges, such organizations voluntarily may request a formal recognition of exempt status by filing a Form 1024 (Application for Recognition of Exemption under Section 501(a)).

If such an organization voluntarily requests a determination letter by filing Form 1024 within 27 months of the end of the month in which it was formed, its determination of exempt status, once provided, generally will be effective as of the organization's date of formation.⁷ If, however, the organization files Form 1024 after the 27-month deadline has passed, its exempt status will be formally recognized only as of the date the organization filed Form 1024.

Annual information returns

Exempt organizations are required to file an annual information return, Form 990 (Return of Organization Exempt From Income Tax), stating specifically the items of gross income, receipts, disbursements, and such other information as the Secretary may prescribe.⁸ Exempt from the requirement are churches, their integrated auxiliaries, and conventions or associations of churches; the exclusively religious activities of any religious order; certain State institutions whose income is excluded from gross income under section 115; an interchurch organization of local units of a church; certain mission societies; certain church-affiliated elementary and high schools; and certain other organizations, including some that the IRS has relieved from the filing requirement pursuant to its statutory discretionary authority.⁹

⁶ Sec. 508(d)(2)(B). Contributions made prior to receipt of a favorable determination letter may be deductible prior to the organization's receipt of such favorable determination letter if the organization has timely filed its application to be recognized as tax-exempt. Treas. Reg. secs. 1.508-1(a) and 1.508-2(b)(1)(i)(b).

⁷ Rev. Proc. 2014-9.

⁸ Sec. 6033(a). An organization that has not received a determination of its tax-exempt status, but that claims tax-exempt status under section 501(a), is subject to the same annual reporting requirements and exceptions as organizations that have received a tax-exemption determination.

⁹ Sec. 6033(a)(3); Treas. Reg. secs. 1.6033-2(a)(2)(i) and (g)(1).

An organization that is required to file an information return, but that has gross receipts of less than \$200,000 during its taxable year, and total assets of less than \$500,000 at the end of its taxable year, may file Form 990-EZ. If an organization normally has gross receipts of \$50,000 or less, it must file Form 990-N (“e-postcard”), if it chooses not to file Form 990 or Form 990-EZ. Private foundations are required to file Form 990-PF rather than Form 990.

Revocation of exempt status

In general

An organization that has received a favorable tax-exemption determination from the IRS generally may continue to rely on the determination as long as “there are no substantial changes in the organization’s character, purposes, or methods of operation.”¹⁰ A ruling or determination letter concluding that an organization is exempt from tax may, however, be revoked or modified: (1) by notice from the IRS to the organization to which the ruling or determination letter was originally issued; (2) by enactment of legislation or ratification of a tax treaty; (3) by a decision of the United States Supreme Court; (4) by issuance of temporary or final Regulations by the Treasury Department; (5) by issuance of a revenue ruling, a revenue procedure, or other statement in the Internal Revenue Bulletin; or (6) automatically, in the event the organization fails to file a required annual return or notice for three consecutive years (discussed in greater detail below).¹¹ A revocation or modification of a determination letter or ruling may be retroactive if, for example, there has been a change in the applicable law, the organization omitted or misstated a material fact, or the organization has operated in a manner materially different from that originally represented.¹²

Upon revocation of tax-exemption or change in the classification of an organization (*e.g.*, from public charity to private foundation status), the IRS publishes an announcement of such revocation or change in the Internal Revenue Bulletin. Contributions made to organizations by donors who are unaware of the revocation or change in status ordinarily will be deductible if made on or before the date of publication of the announcement.

Automatic revocation for failure to file information returns

If an organization fails to file a required Form 990-series return or notice for three consecutive years, the organization’s tax-exempt status is automatically revoked.¹³ A revocation for failure to file is effective from the date that the Secretary determines was the last day the organization could have timely filed the third required information return or notice. To again be

¹⁰ Treas. Reg. sec. 1.501(a)-1(a)(2).

¹¹ Rev. Proc. 2014-9, sec. 12.

¹² *Ibid.*

¹³ Sec. 6033(j).

recognized as tax-exempt, the organization must apply to the Secretary for recognition of tax-exemption, irrespective of whether the organization was required to make an application for recognition of tax-exemption in order to gain tax-exemption originally.

If, upon application for tax-exempt status after an automatic revocation for failure to file information returns, the organization shows to the satisfaction of the Secretary reasonable cause for failing to file the required annual notices or returns, the organization's tax-exempt status may, in the discretion of the Secretary, be reinstated retroactive to the date of revocation. An organization may not challenge under the Code's declaratory judgment procedures (section 7428) a revocation of tax-exemption made for failure to file annual information returns.

The Secretary is authorized to publish a list of organizations whose exempt status is automatically revoked.

Description of Proposal

The proposal requires that the IRS provide notice to an organization that fails to file a Form 990-series return or notice for two consecutive years not later than 300 days after the date of the second failure. The notice must state that the IRS has no record of having received such a return or notice from the organization for two consecutive years and inform the organization about the consequences of failing to file such a return or notice by the date of the next filing deadline. The notice must also contain information about how to comply with the annual information return and notice requirements under sections 6033(a)(1) and 6033(i).

The proposal also provides that the Secretary may reinstate the exempt status of an organization that had its exempt status automatically revoked for failing to file an information return or notice for three consecutive years if (1) the organization demonstrates to the satisfaction of the Secretary that it did not receive the above-described notice from the IRS, and (2) files an annual return or notice for the current year. Under such circumstances, the exempt status is reinstated as of the date of revocation.

Effective Date

The proposal is effective for notices and returns required to be filed after December 31, 2014.

B. Estimated Revenue Effects

The proposal is estimated to have a negligible effect on Federal fiscal year budget receipts for the period 2015-2025.