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IRS Releases Group Exemption Questionnaire as Part of Compliance Check Initiative

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The IRS has recently issued an extensive questionnaire, [available here](#), aimed at understanding how associations, charities and other federally tax-exempt organizations that hold a group exemption ruling oversee their subordinates and comply with annual filing and disclosure requirements. While completing the questionnaire is technically voluntary, organizations that fail to do so may be inviting a more formal and intensive IRS examination. The form is being sent to a random selection of over 2,000 central organizations, and it must be completed online. Responses are due within 60 days of receipt of the form, but the IRS will grant another 30 days to respond if needed.

Additionally, the cover letter for the questionnaire can be accessed [here](#), and a common questions and answers statement from the IRS about the process can be found [here](#).

Background

The group exemption process allows a "central organization" that is federally tax-exempt to have closely related "subordinates" also receive recognition of their federal tax-exempt status through a one-time request, without each subordinate being required to file its own application with the IRS. For example, a national organization with nationwide chapters can gain recognition of tax-exempt status for each chapter without going through the detailed application process multiple times. The rules for obtaining and maintaining this group exemption recognition are set forth in a 1980 Revenue Procedure (Rev. Proc. 80-27, 1980-1 C.B. 677). The current group exemption process envisions the central organization assuming the role of the IRS in ensuring that each of its affiliates is operating consistent with its tax-exempt status. Group rulings are available to 501(c)(3) charities, 501(c)(6) trade associations and professional societies, and virtually all other types of tax-exempt organizations that have subordinates or chapters.

A central organization maintains a group exemption by filing annual reports with the IRS, at least 90 days before the close of its fiscal year, confirming that the subordinates are still active and included in the group exemption. The central organization can remove or add any subordinates as appropriate. Separate from this annual report, both the central organization and the subordinates also must comply with Form 990 filing requirements. The central organization may elect to file an annual group Form 990 (distinct from its own Form 990) for all subordinates covered in its exemption letter (most choose not to do so) or it may choose to have subordinates file on their own.

In recent years, the group exemption process has become an area of interest for the IRS and exempt organization practitioners. In 2011, the IRS Advisory Committee on Tax Exempt and Government Entities (ACT) released a report analyzing the current group exemption process and return system. The ACT Report suggested the elimination of the group Form 990 return form as well as several changes to the group exemption process. In particular, the report recommended updating guidance to central organizations on the meaning of "general supervision or control" over subordinates, given the variety of organizational structures that exist. Additionally, the IRS has begun using IRC § 6033(j), enacted in 2006, to automatically revoke tax-exempt status for organizations that failed to file annual Forms 990 for three consecutive years. A large number of group exemption subordinates have since been affected by this automatic revocation.

After the conclusions of the ACT Report and the results of the first round of automatic revocations, the Tax-Exempt and Government Entities division leadership announced in its 2012 workplan that it would use questionnaires to analyze the group exemption issue. On October 15, the IRS released a reference

copy of the questionnaire, and a number of central organizations have already received a copy from the IRS.

Key Portions of the Questionnaire

The lengthy, detailed questionnaire has nine parts and contains 80 questions, some with subparts. The following topics are covered:

- . Information about the central organization
- . Information about all subordinates
- . Communications with subordinates
- . Relationships with subordinates
- . Services provided for subordinates
- . Inclusion of subordinates in the group exemption ruling
- . Form 990-T filing information
- . Annual information returns and group returns
- . Annual group exemption updates

The focus of the first five parts is on the level of control and interaction between the central organization and its subordinates, while the remaining sections require responses about how IRS filing requirements are being met.

Parts 1 and 2 ask for basic information about the central organization and its subordinates, including the type of tax-exempt status that is applicable. Part 2 asks for information on the structure of the subordinates and their similarity to one another in terms of their services and activities. In addition, several questions ask about possible fees paid by subordinates in order to be included in the group exemption. This section also contains questions about whether any subordinates are involved in political activity, lobbying, and non-tax-exempt activities. These questions appear to be aimed at determining the extent to which a central organization has actually taken the responsibility of determining whether its subordinates should be included in a group exemption. For example, the IRS asks whether any subordinates are organized in a foreign country; existing rules prohibit the inclusion of a foreign-based subordinate in a group exemption. As such, a “yes” answer to this question would mean that the organization was not properly following IRS rules.

Building on this theme, Part 4 asks for information about the level of management control the central organization exercises over its subordinates. These questions focus on the appointment of directors, compensation structures, veto power, performance reviews of subordinates, budget approval, and the types of records kept about each subordinate by the central organization. Part 5 continues this focus by asking about what services, such as training and fundraising assistance, the central organization provides. These portions of the form generally go to the closeness of the relationship between an organization and its subordinates and to the requirement that subordinates be subject to general supervision or control in order to qualify for inclusion in a group exemption.

Parts 6 through 9 are focused on how the central organization maintains its responsibility to file both group exemption updates and an annual Form 990 and how its subordinates also comply with Form 990 filing requirements. Parts 6 and 9 each focus on how the central organization has added and removed subordinates to and from its group exemption in its annual reports and about its internal guidelines for adding and removing subordinates. Parts 7 and 8 focus specifically on the tax years 2008 through 2010. These sections are concerned with which entities have met the Form 990 filing requirements. Questions here concern whether subordinates have filed Forms 990 themselves or whether a group return has been used.

This part of the questionnaire is most concerned with the specific requirements of a group return; the questions concern which subordinates were included, the assets of those subordinates, and whether a written statement was obtained for each subordinate before inclusion. The section also inquires as to whether any subordinates have disclosed certain information, such as their portion of compensation or their portion of expenses, outside of the group return. Further, this portion asks about compliance with Form 990-N for subordinates whose annual gross revenues are less than \$25,000. This question highlights a change in the law, effective in 2008, that requires all tax-exempt organizations with annual gross revenues at or below this dollar amount to file Form 990-N annually.

Conclusion

Due to the extensive nature of the questionnaire and the IRS interest in how organizations have been

handling filing Forms 990, it is safe to conclude that the IRS is closely scrutinizing existing and would-be group exemption holders. Associations, charities, and other tax-exempt organizations that fit into this category should look closely at their current processes and documentation and see where improvements can be made with an eye toward better compliance. In prior instances when the IRS has embarked on compliance check programs (e.g., credit counseling agencies, colleges, and universities), a coordinated series of audits of those organizations were subsequently pursued by the IRS. While it is too early to tell whether that will be the case here, there is no question that the IRS has a heightened interest in group exemptions, and it would appear to be a near certainty that changes in the process will follow in the future.

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