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Group Exemptions: A Primer

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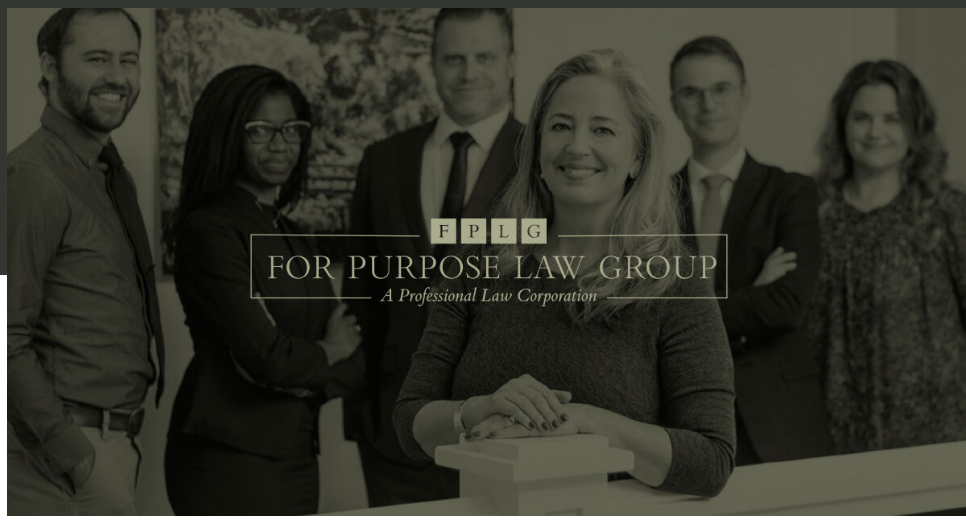

We've heard a lot recently about national 501(c)(3)s with affiliates around the U.S. Some are merging with compatible, multi-chapter organizations; others are coming apart at the seams.

With fundamental reorganizations come lots of tricky legal issues: ownership of the corporate name, control of assets, and personnel shakeups – to name only a few.

There's also the matter of tax-exempt status. Many of these multi-level organizations have group tax exemptions. How to reconfigure and reallocate these valuable IRS approvals is no simple matter. So, what – exactly – is a group exemption?

Group Exemptions: The Basics

The IRS is upfront about the group exemption program: it's –

> *an administrative procedure which has been in existence for several decades. The procedures were instituted to relieve the Service from the burden of individually processing a large number of applications involving the exempt status of organizations that are affiliated with each other, and also are organized and operated for the same purpose.*

Of course, it's also a huge convenience to those organizations that choose this streamlined method of applying for the all-important tax-exempt status.

"A group exemption letter," according to the IRS, "is a ruling or determination that is issued to a central or parent organization (generally, a state, regional, or national organization) which holds that one or more subordinate organizations (usually a post, unit, chapter, or local) are exempt from federal income tax by virtue of being subordinate organizations of a central or parent organization." For ease of reference, we'll use the terms "parent" and "subordinates."

Simply put, if the parent successfully obtains a group exemption letter, then the subordinates need not go to the trouble of submitting "individual documentation to support each of their claims for exemption. Instead, the [parent] will attest that the subordinates are organized and operated under the rules and regulations for a particular category of tax exemption, for example, 501(c)(3) [charitable organizations] or 501(c)(6) [trade associations]. The subordinates are relieved from filing their own applications for recognition of exemption and the IRS doesn't have the burden of reviewing lots of duplicative material.

Whether there is a valid group exemption letter that lists and includes the subordinates, or there are individual tax-exemption determination letters issued to each of the subordinates, the operating rules for the parent and all of the subordinates are the same.

There are over 4,300 group exemptions covering approximately 500,000 subordinates. This figure doesn't include church-group exemptions, some of which cover tens of thousands of subordinates.

How is a Group Exemption Letter Obtained?

The procedure is explained in Revenue Procedure 84-46, 1984-1 C.B. 541 and explained more fully in the tax agency's helpful Publication 4573.

First, the parent files its own application for recognition of tax exemption. Providing this parent meets all of the qualifications of the particular category of tax exemption it seeks – section 501(c)(3), for example – "it may obtain a group exemption letter if it has one or more subordinate organizations under its general supervision and control." (Section 501(c)(3)s that are private foundations are not eligible for this procedure.)

Rev. Proc. 84-46 and Publication 4573 give full details, including what information and supporting documentation is needed.

Who May Be Included in a Group Exemption?

If the parent successfully shows it is entitled to the requested tax exemption, then "a group exemption letter may be issued for subordinates which the parent certifies will be organized and/or operated according to sample documents submitted to support exemption."

If one or more subordinates already have their own IRS determination letters, those prior approvals will be superseded and extinguished by the group exemption.

Maintaining the Group Exemption

In the years after the group exemption letter is issued, there are annual requirements to maintain the group exemption in good standing.

Annual Updates

Every year, at least 90 days before the close of the annual accounting period,

each parent must inform the IRS about all changes in the "purposes, character or method of operation of subordinates included in the group exemption letter."
In addition, the subordinates must be listed with any name or address changes, and indications if they should no longer be included in the group exemption "because they have ceased to exist, disaffiliated or withdrawn their authorization to the "parent."

Information Returns
Each subordinate may choose whether or not to be included in each year's group Form 990 information return. There's no single, correct choice for all situations.
The key argument weighing in favor of some or all of the subordinates joining in filing the group information return is the matter of efficiency; fewer returns need to be prepared for filing, and key information – financial statements, for instance – is routinely prepared on a consolidated basis.
On the other hand, "[t]he requirements and reporting rules for group returns can be cumbersome, and the time saved preparing fewer 990s could be offset by the increased requirements for a group return. The detail supporting data needed for individual 990s will, to a great degree, still need to be developed in a group setting…."
Also, there are policy arguments weighing against a consolidated Form 990 for the group. The IRS Advisory Committee on Tax-Exempt and Government (ACT) "…sees the group filing exemption as an unfavorable planning mechanism for exempt organizations" because of the lack of transparency and accountability where there is just one consolidated return and no individualized information on each subordinate.

Conclusion
The decision, at the beginning of an organization's life cycle, to use a multi-level model and apply for a group exemption, is a critical one, with ramifications far beyond the incorporation time frame. The pros and cons should be carefully weighed in light of the specifics of each group's particular situation.