ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(ACT)

Exempt Organizations:
Group Exemptions – Creating a Higher Degree of Transparency, Accountability, and Responsibility

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I. Executive Summary

Each year, tens of thousands of organizations file individual applications with the Internal Revenue Service (IRS) for recognition of their tax-exempt status. But for more than seventy years, the IRS has also had procedures permitting certain affiliated organizations to obtain recognition of their exemption on a group basis, rather than by filing separate applications. Under these group procedures, one of the organizations (called the central organization) submits a request for recognition of exemption for a group of organizations that are affiliated with it and under its general supervision or control (called the subordinate organizations). If the IRS grants this request, the central organization is authorized to add other similar subordinates to the group, as well as to delete subordinates that no longer meet the group exemption requirements. Central organizations (other than churches) are required to notify the IRS annually of additions and deletions to the group exemption. As a result of the group exemption procedures, subordinate organizations covered by group exemptions are relieved from filing their own individual applications for recognition of exemption with the IRS. The central and subordinate members of a group are covered by all the same rules relating to their exempt status as other exempt organizations, including the requirement to file annual Forms 990. Group exemption holders, however, have the option of filing a group or aggregated Form 990 for two or more of their subordinate organizations, thus relieving those subordinate organizations from having to file separate Forms 990.

There is no question that the group exemption procedures have simplified the process for obtaining exempt status for hundreds of thousands of organizations—and for the IRS—over the years. However, there have been some significant changes in the law and regulatory environment affecting the tax-exempt sector since the issuance of Revenue Procedure 80-27, the most recent group exemption revenue procedure. Among other things, the Pension Protection Act of 2006 (PPA) made significant changes in the laws governing exempt organizations, including the treatment of organizations classified as supporting organizations under section 509(a)(3) of the Internal Revenue Code. The Form 990 has been significantly revised to require a much higher degree of disclosure regarding the organizational structure, activities, governance, revenues and expenditures of exempt organizations. Exempt organizations make their Forms 990 available, easily and free of charge, on their own websites. They are also available on other websites such as GuideStar.org. Thus, Forms 990 are readily accessible to the public, the media and other stakeholders in the nonprofit sector as a source of information about specific exempt organizations. And states are increasingly reliant on the information provided on Form 990 for their own regulatory purposes.

The impact of these and other recent developments in the tax-exempt sector on the group exemption procedures merits consideration. The consistent theme has been to promote a greater degree of **transparency**, **accountability**, and **responsibility**, three tax policy objectives that underlie federal and state laws,

regulations, rules and procedures within the exempt sector. This project, undertaken at the suggestion of the IRS, grew out of the ACT's belief that the time is right to examine the group exemption procedures to consider whether they are consistent with these three tax policy objectives, and, if not, whether group exemptions should be retained or if changes should be made to enhance the ability of the group exemption procedures to achieve such objectives. As we pursued the project, we discovered various challenges and frustrations with the group exemption procedures on the part of the IRS and group exemption holders alike. While some of these appear to stem from inherent limitations of existing technology and internal processes that are not readily addressed, others—including some issues involving churches (which represent a very large body of group ruling holders)—raise legitimate concerns for which solutions should be sought. We have made note of these where relevant and appropriate.

This report explains the process that the ACT followed; describes the historic and current framework for group exemptions and group returns; and examines the benefits, challenges and limitations of group exemptions and group returns. It explains the basis for the ACT's determination that group exemptions should be retained, but the current group exemption procedures should be updated. Finally, the report makes the following recommendations as to how the group exemption procedures could be revised to achieve greater transparency, accountability and responsibility.

1. Allowing group exemption holders to file group Form 990 returns does not provide the IRS, the states, or the public with adequate transparency about the activities of subordinate organizations covered by a group exemption, or serve as a mechanism to promote adequate accountability by the subordinate organizations on an individual basis. We recommend eliminating group returns by amending Treasury Regulations section 1.6033-2(d) to remove the authority of central organizations to file group returns.

2. Revenue Procedure 80-27 does not define or explain how central organizations are expected to exercise on-going general supervision or control over their subordinate organizations. This lack of guidance makes it difficult for group exemption holders to exercise appropriate responsibility with respect to their subordinate organizations and creates a lack of accountability in meeting unstated and unknown expectations. We recommend updating Revenue Procedure 80-27 to provide such guidance and that the revision be issued in proposed form for public comment. As part of this process, special consideration should be given to the development of appropriate standards to address the varied organizational structures and unique legal status of churches.

3. Group exemption holders are not required to disclose to the public their list of subordinate organizations or any other information about the composition of the group. Nor are they required to disclose to the public or the IRS the procedures they follow to exercise on-going general supervision or control in compliance with Revenue Procedure 80-27. This disclosure vacuum

contributes to a lack of transparency and accountability with respect to group exemption holders. We recommend requiring group exemption holders that have a Form 990 filing requirement to disclose, on Schedule O of the Form 990, information about the composition of the group and how the central organization exercises general supervision or control. To ensure that all groups provide this disclosure, we recommend that each central organization with a Form 990 filing requirement be required to file Form 990, even if it would otherwise be eligible to file Form 990-EZ or 990-N.

4. While section 501(c)(3) subordinate organizations covered by group exemptions are generally listed in the Exempt Organizations Business Master File (EOBMF),[1] they are not listed in Publication 78, making it impossible for donors to verify readily the ability of section 501(c)(3) subordinate organizations to receive tax-deductible charitable contributions. Recent IRS efforts to educate donors about their ability to rely on group exemption confirmations given by the central organization, while appreciated by the sector, have met with mixed success at best. We recommend that the IRS work with section 501(c)(3) group exemption holders, including churches, to develop workable new options for including subordinate organizations in Publication 78 or otherwise providing donors with additional information regarding the deductibility of contributions that exists for other tax-exempt charities.

5. Changes made by the PPA in the definitions and tax laws governing section 509(a)(3) supporting organizations raise a question as to whether it continues to be appropriate for them to be included in a group exemption ruling. On balance, we believe that "Type III" supporting organizations should not be included in a group exemption ruling. We recommend that this be addressed as part of a project to issue an updated version of Revenue Procedure 80-27 for public comment.

6. Finally, we recommend that there be a significant transition period for existing groups to come into compliance with any changes to the group ruling procedures. Moreover, special consideration should be given to existing church group exemptions, as they are some of the largest and oldest of all group exemptions. (Some church group exemptions have tens of thousands of subordinate organizations and some have been in place for 60 years or more.) We recommend the IRS seek comment from existing group exemption holders before setting any time limits for a transition period.

[1] Historically, subordinate organizations in church group rulings have generally not been listed in the EOBMF. However, it is the ACT's understanding that current IRS policy is to include church group ruling subordinates in the EOBMF if the central organization, through annual updates or otherwise, voluntarily provides the IRS with information about these organizations.

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II. Statement of Problem and Project Objectives

A. Problem

There have been many significant changes in the laws affecting tax-exempt organizations since the issuance of the first group exemption in 1940. Laws have been enacted and regulations issued requiring section 501(c)(3) organizations (other than churches) to seek recognition of exemption and imposing annual information filing requirements (Form 990) on most categories of exempt organizations (other than churches). Changes have been made in the laws governing categories of section 501(c)(3) organizations, including the private foundation excise taxes in Chapter 42 of the Internal Revenue Code and, most recently, the laws governing supporting organizations.

Laws have also been enacted and regulations issued to promote greater access to information about tax-exempt organizations, for example, requiring that annual information returns (Forms 990) be made available to the public. (And institutions such as GuideStar provide online the Forms 990 for thousands of organizations.) At the urging of the Congress, the states, and the public, the IRS has undertaken more recent initiatives to improve the quality and accessibility of information about exempt organizations by redesigning the Form 990. The IRS has also put Publication 78, its *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*, on line, making it easier for donors to check the section 501(c)(3) status of organizations before making a grant or charitable contribution.

For many years, the IRS regularly updated its group exemption procedures in light of the changes in law, regulations and procedures. However, no changes have been made to the group exemption procedures since 1980, raising the question as to whether the existing procedures remain adequate for the intended purposes. In addition, the IRS and group exemption holders have expressed frustration with various aspects of the existing group exemption procedures, and this also warrants consideration.

B. Project Objectives

Over the past three decades since the IRS last updated the group exemption procedures, substantial attention has been focused on the importance of transparency, accountability, and responsibility within the tax-exempt sector. The laws, regulations and procedures governing exempt organizations have, at their heart, these three tax policy considerations. While there is no statutory or regulatory definition of these terms, we believe they are commonly understood to have the following meanings.

Transparency refers to making information available regarding the organization's structure, operations, activities, finances, and tax status – such as the type of information that is now required on Form 990 for organizations that have a filing

requirement. A wide variety of stakeholders — the IRS, the states, donors, the public, the media, and others — rely on this information for regulatory and information purposes. Accountability refers to meeting obligations to the same group of stakeholders to use tax-exempt funds in a manner consistent with the intended purposes. Responsibility refers to compliance with the laws and rules governing the organization's exempt status.

The objectives of this project are to examine the group exemption procedures to see whether they continue to serve a useful purpose, and to consider whether changes are needed to increase the transparency, accountability and responsibility of central organizations holding group exemptions and the subordinate organizations covered by them.

III. Process

The ACT reviewed all formal and informal guidance issued by the IRS relating to group exemptions and the filing of group returns, including regulations, revenue procedures, publications, the Internal Revenue Manual, private letter rulings, and the Form 990 instructions for the filing of group returns. The IRS provided historical information about the development of group exemptions, along with statistical data regarding the number of group exemptions and the section 501(c) subsection classification of the central and subordinate organizations. We were also provided some statistical information about group returns.

The ACT conducted a series of interviews with IRS officials and staff. These interviews focused on issues, challenges, and concerns associated with the group exemption procedures from the IRS perspective, as well as the feasibility of various options that might exist for making changes to the procedures. The ACT received a great deal of helpful information about the history of the group exemption procedures as well as challenges associated with applying the normal IRS procedures in the context of group exemptions.

The ACT also obtained information from members of the National Association of State Charity Officials (NASCO).[2] In order to determine the impact of group exemptions and group returns on the exercise of state charity regulators' authority and the dissemination of information to the public, a member of the ACT collected information from, and discussed the group exemption and group return procedures, with over 15 state charity regulators.

In addition, the ACT collected information and documents from ten large and medium-sized church denominations that hold group exemptions, including responses to a questionnaire prepared by the ACT. Several members of the ACT met in person with representatives from eight denominations, both individually and as a group. These representatives shared information about the operation of their group exemptions and discussed issues they identified with the group exemption procedures.

Members of the ACT also interviewed a number of non-church group ruling holders and subordinate organizations exempt under sections 501(c)(3), 501(c)(4), 501(c)(7), 501(c)(9), 501(c)(14), and 501(c)(19). These organizations ranged from large, nationwide organizations, to smaller regional and state-based entities.

[2] The National Association of State Charity Officials is made up of representatives of state agencies, including Attorneys General, Secretaries of State and Commissioners of Consumer Affairs whose responsibilities include oversight of tax-exempt entities. That oversight includes ensuring that charitable assets are appropriately managed, that donor intent is fulfilled, and that fraudulent fundraising is remedied.

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IV. Background on Group Exemptions

A. Number and Profile of Group Exemption Holders

There are currently over 4,300 group exemptions covering approximately 500,000 subordinate organizations. These statistics do not include church group exemptions because they are not required to file annual information reports with the IRS regarding additions and deletions of subordinate organizations from their group exemptions. From our conversations with church group exemption holders, we learned that some church group exemptions cover thousands and even tens of thousands of subordinate organizations. Based on this information, we estimate that there are something on the order of 100,000 to 150,000 churches and other subordinate organizations covered by group exemptions, in addition to the numbers listed above. Also, approximately 600 – 700 of the more than 4,300 central organizations holding group exemptions elect to file group Form 990 returns on behalf of some or all of their subordinate organizations.

Group exemptions exist for many categories of exempt organizations, including subordinate organizations exempt under sections 501(c)(3), (4), (5), (6), (7), (8), and (19). Section 501(c)(3) organizations comprise the largest single segment of the group ruling universe. Approximately 2,500 of the 4,300 group exemptions are held by section 501(c)(3) central organizations, and there are approximately 250,000 section 501(c)(3) subordinate organizations (again, excluding churches, their integrated auxiliaries and affiliated subordinates). Some of the group exemptions cover a relatively small group of subordinate organizations (as few as one); others cover a very large group of subordinate organizations (as many as 30,000 – 40,000 or more).

Group exemption holders include many well-known section 501(c)(3) organizations such as the American Cancer Society, Habitat for Humanity, and the National Association for the Advancement of Colored People. Also, many large religious denominations hold group exemptions, including the Catholic Church, United Methodist Church, Presbyterian Church (U.S.A.), Seventh-day Adventist Church, and The Church of Jesus Christ of Latter-day Saints, to name just a few. Other well-known group exemption holders include labor unions (*e.g.*, the International Brotherhood of Teamsters), Hillel The Foundation for Jewish Campus Life, Veterans of Foreign Wars, Knights of Columbus, Benevolent and Protective Order of Elks, Rotary International, and certain state League of Women Voters and PTA organizations.

B. Pre-1980 IRS Group Exemption Procedures

The earliest group exemptions apparently pre-date the Internal Revenue Code of 1939, although IRS records indicate that the first “official” group exemption was issued on March 14, 1940. Until the issuance of Revenue Procedure 68-13, the IRS handled group exemption requests on a case-by-case basis, without any formal administrative guidance on the process or requirements. Revenue

Procedure 68-13 established the substantive requirements for inclusion in a group exemption, as well as the procedures for obtaining a group exemption, the annual filing requirements to maintain the group exemption, and the consequences of terminating the group exemption.

Revenue Procedure 68-13 provided that a "central" organization already recognized as exempt could apply for exemption for "subordinate organizations" that met four requirements: (i) they were affiliated with the central organization; (ii) they were subject to the central organization's "general supervision or control;" (iii) they were all exempt under the same paragraph of section 501(c), although not necessarily the same paragraph as the central organization; and (iv) they provided written authorization to be included in the application for group exemption.

Revenue Procedure 68-13 required the central organization to submit a letter, signed by one of its principal officers, verifying the existence of affiliation and general supervision or control over the subordinate organizations; describing the principal purposes and activities of the subordinates; providing a sample of the governing document for the subordinates; affirming (to the best of the officer's knowledge) that the subordinates operated in accordance with the stated purposes; and confirming that each subordinate had provided written authorization to be included in the group ruling. The central organization also had to include a list of the names, addresses, and employer identification numbers of the subordinates to be included in the group exemption.

Once a group exemption was granted, the central organization was responsible for determining whether new subordinates met the requirements to be covered by the group exemption, for monitoring the continued compliance of existing group members with the requirements for exemption and for keeping the IRS updated on additions, deletions, and other changes to the group's subordinate organizations. Revenue Procedure 68-13 imposed an annual filing responsibility on central organizations, requiring them to file an annual report with the IRS providing information regarding "all changes in the purposes, character, or method of operation" of the subordinates in the group exemption, as well as the names, addresses, and EINs of subordinates that (i) have changed their names or addresses, (ii) are no longer included in the group exemption, and (iii) have been newly added to the group exemption. Revenue Procedure 68-13 provided that a central organization could submit an annual directory to meet the annual filing requirement, as long as it annotated the directory to include the three categories of information required in the preceding sentence. With respect to newly added subordinates, central organizations were also required to provide the same information required in the original request, or to confirm that the information submitted in the original request is applicable "in all material respects" to the new subordinates.

Revenue Procedure 68-13 explained the consequences of a termination or revocation of the group exemption, which could occur if the central organization

dissolved, lost its exemption or failed to meet the annual filing requirements, as well as the consequences if one or more of the subordinate organizations were determined not to qualify for exemption.

Finally, Revenue Procedure 68-13 addressed group exemptions and listings in Publication 78, *Cumulative List - Organizations Described in Section 170(c) of the Internal Revenue Code of 1954*. Specifically, Revenue Procedure 68-13 stated that, if a central organization holding a group exemption is eligible to receive deductible charitable contributions as provided in section 170, the central organization will be listed in Publication 78, but the names of the subordinates covered by the group exemption letter will not be listed individually. However, Revenue Procedure 68-13 stated that the "identification of the central organization will indicate whether contributions to its subordinates are also deductible."

The IRS issued three subsequent Revenue Procedures updating the group exemption procedures, although the principal provisions of Revenue Procedure 68-13 remain largely unchanged. Revenue Procedure 72-41, which superseded Revenue Procedure 68-13, added a new requirement that subordinates covered by a group ruling could not include organizations classified as private foundations under section 509(a). Revenue Procedure 72-41 also withdrew the provision allowing a central organization to submit an annotated annual directory to satisfy the annual filing requirement, requiring instead that all central organizations submit annual information in the same format. Finally, Revenue Procedure 72-41 deleted the language in Revenue Procedure 68-13 discussing group exemptions and listings in Publication 78.

Revenue Procedure 77-38, which superseded Revenue Procedure 72-41, made several fairly minor changes in the group exemption process. It provided that foreign subordinates could not be covered under a group exemption. It also required that subordinates listed in the application for the group exemption must have been formed within the 15-month period prior to the date the group exemption application is submitted, if those subordinates were subject to section 508(a) of the Code.[3] Revenue Procedure 77-38 also expanded the information required to be provided by the central organization in the application for a group exemption to include "a detailed description of the purposes and activities of the subordinates including the sources of receipts and the nature of expenditures." Finally, it added a requirement that private school subordinates comply with Revenue Procedure 75-50 (requiring racially nondiscriminatory policies with regard to admissions, programs, and financial assistance), and spelled out in more detail the conditions for continued effectiveness of a group exemption.

[3] Note this 15-month time period is the usual deadline for an organization to file an application for exemption with the IRS if it seeks recognition of its exempt status retroactive to the date the organization was formed. Treas. Reg. § 1.508-1(a)(2).

C. Current IRS Group Ruling Procedures

1. Revenue Procedure 80-27

Revenue Procedure 80-27 sets forth the current group exemption procedures. It retains most of the provisions of Revenue Procedure 77-38 (described above). Changes from the prior Revenue Procedure relate to the time for filing the annual report (changed from 45 to 90 days before the close of the central organization's tax year), clarifications to the application of the 15-month rule discussed above, and the addition of a requirement that all subordinates must have the same accounting period as the central organization if they are to be included in a group Form 990 return filed by the central organization.

2. Publication 4573

In 2006, the IRS issued Publication 4573, which contains a series of questions and answers about group exemptions. That publication, most recently revised in 2007, provides plain-language information about some of the most important aspects of group exemptions. For the most part, Publication 4573 is consistent with Revenue Procedure 80-27, although it makes one substantive change – it states that churches holding group exemptions are not required to file an annual report updating the IRS on changes in their subordinates. The obvious impact of this change is to leave the IRS without updated and accurate information about the identity of the subordinates covered by church group exemptions, at least for those churches that do not, voluntarily, submit such annual reports. However, some church group ruling holders we spoke with said this change simply recognized a long-standing administrative practice of the IRS (which has since been changed) not to update its records with information submitted in church group exemption annual reports.

3. 1994 ABA Tax Section Comments on Revenue Procedure 80-27

Although Revenue Procedure 80-27 has been existence for more than three decades and has been modified, at least informally, by Publication 4573, the IRS has not initiated a formal process to review and update the group exemption procedures. In 1994, the Exempt Organizations Committee of the Section of Taxation of the American Bar Association submitted comments to the IRS recommending that Revenue Procedure 80-27 be modified to remove the requirement that the central organization have "general supervision or control" of subordinates, at least in the case of churches and religious organizations, and to replace that with a requirement that the central organization have sufficient "affiliation bonds" that it will be able to provide accurate, timely, and regular information to the IRS regarding the subordinates covered by the group exemption.

These comments were prompted by several considerations, including the following:

(1) many churches and other religious organizations are prohibited by theological doctrine or practices from controlling or supervising other entities within the denomination or religious association; and

(2) central churches and religious associations should not have to represent that they control or supervise affiliated entities, since such representations are frequently used against the central church or religious association in tort litigation.

The latter consideration is reflected in the case of *Barr v. United Methodist Church*, 90 Cal. App. 3rd 259, 153 Cal. Rptr. 322 (1979), in which the court used, in part, information from a central organization's group ruling application to hold that the *entire denomination* could be sued in a dispute involving some retirement homes affiliated with a regional body of the church.

D. Donor Reliance on Group Exemptions

As a general matter, a donor making a contribution to a charitable organization is entitled to rely on the organization's listing in Publication 78 for assurance that the contribution will be deductible. When an organization loses exemption, the IRS removes it from Publication 78, and donors can no longer rely on the organization's original exemption letter. Publication 78 is available on-line, and it is used by a wide variety of donors, including individuals, foundations, and companies making matching gifts, to check the tax-exempt status of an organization before making a contribution or grant.

Generally, subordinates covered by a group exemption are not listed individually in Publication 78, but donors are entitled to rely on confirmation from the central organization that the subordinate is covered by the group exemption. Publication 4573 specifically addresses this point with two questions on how donors may verify that a subordinate is covered by a group exemption, and what they may rely on in making a charitable contribution to a subordinate that does not have its own exemption. These questions and answers are as follows:

How do I verify that an organization is included as a subordinate in a group exemption ruling?

The central organization that holds a group exemption (rather than the IRS) determines which organizations are included as subordinates under its group exemption ruling. Therefore, you can verify that an organization is a subordinate under a group exemption ruling by consulting the official subordinate listing approved by the central organization or by contacting the central organization directly. You may use either method to verify that an organization is a subordinate under a group exemption ruling.

How do donors verify that contributions are deductible under section 170 with respect to a subordinate organization in a section 501(c)(3) group exemption ruling?

Donors should consult IRS Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*, or obtain a copy of the group exemption letter from the central organization. The central organization's listing in Publication 78 will indicate that contributions to its subordinate organizations covered by the group exemption ruling are also deductible, even though most subordinate organizations are not separately listed in Publication 78 or on the EO Business Master File. Donors should then verify with the central organization, by either of the methods indicated above, whether the particular subordinate is included in the central organization's group ruling. The subordinate organization need not itself be listed in Publication 78 or on the EO Business Master File. Donors may rely upon central organization verification with respect to deductibility of contributions to subordinates covered in a section 501(c)(3) group exemption ruling.

E. Group Returns

In general, the fact that a group exemption exists does not change the Form 990 filing requirements for either the central or subordinate organizations. A central organization and all of the subordinate organizations must each file a Form 990, unless the organization satisfies a filing exception (such as for churches). However, the central organization may file a group return on behalf of those subordinate organizations that elect to be included in the group return.[4] *See* Treas. Reg. § 1.6033-2(d).

With the increased disclosures contained in the redesigned Form 990, the proper completion of a group return filed by a central organization on behalf of some or all of its subordinate organizations creates challenges. In order to file a complete and accurate group return, the central organization is required to collect the appropriate data from each of the subordinates — in effect, requiring each subordinate to provide the central organization with all of the same information it would need to complete its own Form 990. The central organization is then required to aggregate the data from all subordinate organizations that have elected to join the group return and to report this information in the group return in accordance with Appendix E of the instructions for the Form 990.

These instructions on group returns require the reporting of some required Form 990 information on an aggregate basis. For example, when reporting the number of volunteers on the Form 990, Part I, line 6, the central organization is required

[4] If a central organization is subject to a filing requirement, it must always file its own separate return, regardless of whether it files a group return for some or all of the subordinate organizations.

to aggregate the total number of volunteers for all of the subordinate organizations included in the group return. But other information is required to be reported on an individual basis, which may present a reporting challenge. For example, the instructions provide that answers to the yes/no questions in the return must accurately reflect the activities of each of the subordinate organizations when the answers are not the same for all subordinate organizations in the group return. Thus, the central organization must explain in Schedule O the different answers for the different subordinate organizations.

As another example of this dichotomy of aggregate and separate reporting in a group return, the compensation of the officers, directors, trustees, and key employees of each subordinate organization is required to be disclosed in both Part VII of the Form 990 and Schedule J. However, information with respect to highly compensated employees, and independent contractors, is only required to be reported for the highest paid among the whole group of subordinates, and not on a subordinate-by-subordinate basis.

In some cases, completing the Form 990, as required in the instructions, may mask potential issues that exist with respect to individual subordinates. For example, in the case of section 501(c)(3) organizations, the Form 990 instructions require reporting of public support information in Schedule A on an aggregate basis. This makes it impossible to determine whether each individual subordinate meets the requisite public support test. This is a particular concern, because the aggregate reporting could easily mask the fact that an individual subordinate organization has failed the public support test and should be properly classified as a private foundation. Private foundations are not eligible to be included in a group exemption and are, of course, subject to many restrictions that are not applicable to public charities. There is a similar issue with respect to the reporting of lobbying information; the aggregate reporting does not allow the IRS (or the public) to discern on a group return if each individual section 501(c)(3) group member is operating within its lobbying limits.

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V. Information Obtained from Stakeholders

In conversations with the IRS, we discussed its concerns about whether the current group exemption process provides sufficient transparency, accountability, and responsibility. We also discussed alternatives to the group exemption process if it were not retained, including whether existing group exemption holders should be grandfathered or whether a new expedited review process might be created to allow subordinate organizations covered by existing group exemptions to seek individual recognition of exemption on a simplified basis. These were preliminary conversations intended to allow the ACT to gain an understanding of the options that might be available.

The ACT also received very helpful comments from NASCO members. While one NASCO member responded that these group exemption procedures did not impact its ability to fulfill its regulatory responsibilities, members from approximately 15 other states raised concerns that group exemptions, and in particular group returns, present state regulators with problems in enforcing state law and make it difficult for group members to comply with those laws. The problems identified by NASCO members included the following:

> *Difficulty identifying which subordinate organizations covered by a group return are active in a particular state* — One respondent claimed that the lists of subordinates included in group returns are "often nearly impossible to decipher and at the very least difficult to review in order to find [a] specific organization," especially when an individual organization has amended its Articles of Incorporation to change its name and this change is not made known to the central organization. This problem is exacerbated by the fact that many members of groups have similar names, both to other members of the same group and to entirely unrelated groups.
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> *Difficulty identifying officers, directors and employees of subordinate organizations* — Respondents noted that the group return does not identify those individuals — officers, directors, and employees — who oversee and manage the individual subordinates, and who are accountable to the states in which they operate. It is those individuals (rather than the officers and directors of the central organization, which may be located elsewhere), who are accountable to the states and to whom charity regulators look for compliance and accountability. The inability to identify them ties the hands of state regulators in seeking evidence and exercising their enforcement authority.
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> *Inability to break down financial information among group members* — Respondents noted that group returns do not break down financial information among the subordinate organizations and as a result there is no accountability to the states by the individual organizations over which they have regulatory authority. For most states, a group return does not

satisfy the filing requirement applicable to a subordinate organization because such a return does not provide a separate accounting of the revenue and expenses of the individual state registrant. Likewise, group returns do not provide meaningful information to citizens who want to inquire about a particular subordinate.

Impact on compliance with state law — Some NASCO respondents expressed a general concern that the group exemption process may impact the subordinate organizations' compliance with state law. For example, many states do not recognize group exemption at the state level and instead require registration of and filing by each legal entity subject to their jurisdiction. Subordinate organizations covered by a group exemption may not be aware that they have to obtain their own individual state tax exemptions and satisfy individual state filing requirements. In the case of churches, some state definitions of "religious organization" are different from the definition in the Internal Revenue Code, so some organizations that are part of a group exemption and do not have an IRS filing requirement, nevertheless, may be required to register and file annual reports in certain states. For example, a group home included in the IRS group exemption for a church may not be exempt from registration pursuant to a state law that only exempts houses of worship, and may be unaware of the state law requirement.

Lack of documentation for state registration requirements — Some states require exempt organizations to file, as part of their registration, a copy of the registrant's IRS Form 1023. Subordinate organizations may not have access to the form filed by the central organization and therefore have difficulty meeting this requirement, or the central organization's application for a group exemption may have been submitted years before a particular organization was formed or became a member of the group and therefore may not appropriately describe the activities and history of the particular group member.

The ACT also met, collectively and individually, with representatives of church group exemption holders. The principal issue raised by church group exemption holders involved the challenge associated with providing donors with acceptable levels of assurance as to the deductibility of contributions made to subordinate organizations covered by a group exemption. Another issue that was raised related to the interpretation of the general supervision or control standard of Revenue Procedure 80-27 in the context of churches and religious organizations. Also, some church group exemption holders expressed complaints about inadequate training given to IRS personnel who respond to calls from donors and others, inquiring about the tax-exempt status of their subordinate organizations. They also expressed frustration over numerous incidents related to inaccurate information in IRS databases concerning their subordinate organizations.

VI. Analysis of Group Exemptions and Group Rulings

The ACT's analysis of the group exemption procedures focused on three questions: (1) should the group exemption mechanism be retained; (2) do the current group exemption procedures adequately achieve the tax policy objectives of transparency, accountability and responsibility; and (3) how can the current procedures be revised to enhance such tax policy objectives?

A. Should the group exemption mechanism be retained?

The ACT believes that the group exemption process provides an appropriate mechanism for central organizations to seek recognition of exemption on a group basis for organizations under their general supervision or control. The original objective of the group exemption procedures was to lessen the administrative burden on subordinate organizations and on the IRS, and we believe that remains a valid rationale for subordinate organizations and the IRS alike.

With respect to the administrative burden on subordinate organizations, we note that the application for recognition of exemption (Form 1023 for section 501(c)(3) organizations and Form 1024 for most other categories) has become more complex over the past decade. Form 1023, in particular, became significantly more complex when it was last revised in 2006. According to the Form 1023 instructions, the estimated time to prepare and assemble the Form 1023 (without any schedules) is approximately 10.5 hours, to learn about the law or the form is approximately 5 hours, and the estimated recordkeeping time associated with preparation of the form is nearly 90 hours.[5] While we take these estimates with a grain of salt, we believe they are reflective of the level of effort associated with preparing and filing a Form 1023. Also, there is a substantial user fee to file the Form 1023. If the applying organization's average annual gross receipts have exceeded or will exceed $10,000 annually over a four-year period, the user fee is $850. For all other organizations, the user fee is $400.

Because many, if not most, of the subordinate organizations currently covered by group exemptions have substantially the same structure (which has been approved by the IRS in the context of the central organization's group exemption application) and are under the general supervision or control of a central organization, it seems unnecessary to require them to go through the time and expense of submitting separate applications for recognition of exemption. Furthermore, the group exemption process also ensures uniform and consistent treatment of similarly situated organizations, something that is not assured through the normal exemption application process, in which it is not uncommon for applications submitted by similarly situated organizations to receive disparate treatment.

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[5] The Paperwork Reduction Act requires the IRS to provide an estimate, for all tax forms, of the time required for recordkeeping, learning about the law, preparing the form and copying, assembling, and sending it to the IRS. This information can be found on page 24 of the Instructions to Form 1023.

The analysis is similar with respect to the administrative burden on the IRS of individual exemption applications. In recent years, the IRS has made an administrative decision to streamline its application review process for most organizations based on a determination that it can carry out its tax administration responsibilities with a fairly low level of review for most exemption applications. The reason is that many exemption applications are for organizations that are very similar to other existing exempt organizations and by their nature do not require significant analysis. Retaining the group exemption process is a logical corollary of that decision, and has the added advantage of eliminating what would generally be a much more substantial burden on the organizations themselves. Specifically, if group rulings were eliminated, hundreds of thousands of (former) subordinate organizations would need to file individual exemption applications with the IRS. These applications would be in addition to the already significant normal volume of applications currently being processed with limited IRS resources. Because many of these organizations would be similar to each other or to other organizations that have already been granted exemption, presumably many of these applications would not require substantial review by the IRS. But that, in turn, raises the question of what then is the relative value to the IRS, the public, donors, and others of a minimal review of all these applications when balanced against the time and expense incurred by the organizations in filing them.[6]

Moreover, in many cases, we believe that the IRS will get a higher degree of on-going compliance with the requirements for exemption by retaining the group exemption procedures. One of the requirements of Revenue Procedure 80-27 is that the central organization exercise on-going general supervision or control over subordinate organizations covered by the group exemption. Central organizations have the authority to delete subordinate organizations from the group exemption if they no longer satisfy all the requirements to be in the group. This provides for an on-going level of oversight by the central organization that can be far greater than what would otherwise exist at the IRS level alone. Even for large groups, the number of their subordinate organizations is dwarfed by the approximately 1.8 million tax-exempt entities regulated by the IRS. In theory at least, the central organization is able to supervise and scrutinize its subordinates more closely — and remove entities that are not complying with IRS requirements more quickly — than the IRS. A good example of this is church group exemptions. By statute, churches, their integrated auxiliaries, and conventions or associations of churches do not have to apply for exemption or file Forms 990. Thus, many of these organizations are virtually invisible to the IRS. The church audit procedures under section 7611 of the Internal Revenue Code (IRC) further limit the ability of the IRS to exercise oversight over these organizations. Hence, the central organization of a church group ruling is in a

[6] It should also be noted that most subordinate organizations in non-church group exemptions currently file annual information returns (Forms 990), which provide more current information about these organizations than an exemption application that would only be filed once.

much better position than the IRS to monitor the activities of the group's subordinates.

In the ACT's interviews with group ruling holders, we found a number of central organizations that provide a level of supervision or control of their subordinate organizations that enhances and ensures their compliance with the requirements for obtaining and maintaining tax-exempt status. In the case of many group exemptions, we believe that the initial and ongoing scrutiny exercised by the central organization — which is often concerned with doctrinal or operational consistency, operational focus and/or reputational risk for the group members — is more probing than that of the IRS. Moreover, as discussed below, we believe that providing central organizations with clearer guidance regarding their general supervision or control obligation, and providing the IRS with more information about how central organizations are fulfilling that obligation, will significantly improve transparency, accountability, and responsibility for group exemptions.

The group exemption process provides another benefit to the IRS with respect to its administration of the tax laws in the case of organizations that are not required to seek recognition of exemption on an individual organization basis, including churches and non-501(c)(3) organizations. Under the group exemption procedures, all categories of exempt organizations — including churches and non-501(c)(3) organizations — must apply to the IRS to obtain a group exemption for their subordinate organizations. This provides the IRS with a base of information that it might not otherwise have about a significant cadre of exempt organizations. This is particularly the case with respect to churches, which, as noted above, would otherwise be invisible to the IRS. Moreover, even though churches are not required to file an annual report to the IRS listing organizations added to and deleted from the group exemption, some voluntarily choose to do so, which provides the IRS with updated information about their subordinates that can be incorporated into the EOBMF.

The principal arguments against retaining group rulings relate to concerns about a lack of transparency, accountability, and responsibility inherent in the process. The ACT believes that eliminating group rulings would, to a limited degree, increase transparency, accountability, and responsibility — each organization that would have been a group member would be required to file an individual exemption application. This would address some of the concerns raised by state regulators, and donors would have full access to the individual exemption applications. Moreover, each entity that receives recognition of its exempt status through an individual application would be listed in the EOBMF and, if recognized as a section 501(c)(3) organization, Publication 78, solving the concerns raised about easily verifying exempt status.

However, eliminating group rulings (either entirely or prospectively) would also raise several significant concerns:

Retroactive Revocation of Exempt Status — If group exemption rulings were eliminated, existing group ruling members would likely raise legal objections that such an action would be a retroactive revocation of their exempt status by the IRS. As a legal matter, the IRS would presumably argue that no revocation occurred because the group ruling members never received a determination letter from the IRS recognizing their exempt status. In other words, there was no revocation by the IRS because the IRS never granted the individual group ruling members any status that could be revoked. On the other hand, group ruling members could argue that they followed the IRS's own group ruling procedures to establish their exempt status, and those procedures did not require that they apply to the IRS for recognition of that status.[7] Hence, in their view, an administrative action by the IRS to eliminate group rulings would be, at least, a *de facto* revocation of their exempt status by the IRS, and it is certainly conceivable that former section 501(c)(3) group ruling members might file a declaratory judgment action under IRC section 7428.[8] While we express no view on the ultimate outcome of such declaratory judgment actions, we do not believe that the likely arguments to be made by affected group ruling members would be easily dismissed.

Disparate Treatment Resulting from Prospective Elimination of Group Rulings — Even a prospective (only) elimination of group rulings raises some serious concerns. If existing group exemption holders are allowed to retain their group status, and the group ruling process is eliminated only on a going-forward basis, organizations that would otherwise qualify for group status would raise fairness concerns, and may be able to raise legal issues about disparate treatment of similarly situated organizations.[9] (These same issues could also arise if existing group rulings were "frozen," i.e., permitting existing subordinates to continue to be covered by the group ruling, but not allowing new subordinates to be added.) As an

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[7] Also, the Treasury Regulations specifically exempt subordinate organizations (other than private foundations) covered by a group exemption letter from the usual requirement that section 501(c)(3) organizations must file an application with the IRS for recognition of exemption. Treas. Reg. § 1.508-1(a)(3)(i)(c).

[8] *See* IRC § 7428(a)(1)(A) (granting the authority to file a declaratory judgment action in the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia with respect to the "continuing qualification of an organization as an organization described in section 501(c)(3)").

[9] In the context of retroactive application of tax regulations and rulings, courts have required that the IRS treat similarly situated taxpayers in the same manner. *International Business Machines Corp. v. United States*, 343 F.2d 914, 920 (Ct. Cl. 1965) (stating that "[e]quality of treatment is so dominant in our understanding of justice that discretion, where it is allowed a role, must pay the strictest heed"). In other contexts, courts have noted that the IRS has a general responsibility to treat similarly situated taxpayers in a like manner. *Baker v. Commissioner*, 787 F.2d 637 (D.C. Cir. 1986) (noting that "[t]ax cases . . . are encompassed within the general concern that officialdom avoid arbitrary distinctions between like cases"); Ogiony v. Commissioner, 617 F.2d 14 (2d Cir.), *cert. denied*, 449 U.S. 900 (1980) (noting, in a concurring opinion, that "consistency over time and uniformity of treatment among taxpayers are proper benchmarks from which to judge IRS actions").

example, new churches (and their affiliates) that wish to have a group exemption might raise Constitutional issues, arguing that churches with existing group exemptions are receiving more favorable treatment from the government in violation of the Establishment Clause.

Transition Issues — The ACT believes that if group exemptions were eliminated, the transition period would be extremely difficult and disruptive for all stakeholders, including group ruling holders, their subordinate organizations, the IRS, and donors. Indeed, any process transitioning hundreds of thousands of organizations from one regulatory regime to another could not be otherwise.[10]

If group rulings were eliminated, there are several things that could be done to make the transition somewhat easier. For example, former subordinate organizations filing individual exemption applications could be permitted to file a shortened or abbreviated Form 1023 or Form 1024. (On the other hand, we note that a shortened or abbreviated application would necessarily provide less insight into the organization's operations and activities.) All applications from members of the same former group could be sent to the same team of reviewers at the IRS's Cincinnati Service Center, which would reduce the instances of similarly situated organizations receiving inconsistent treatment. Also, establishing a special, lower user fee or imposing the user fee on a group basis, could reduce the cost of filing exemption applications for subordinate organizations.

To address its own processing issues, the IRS could develop a system for phasing in (e.g., over a period of 3-5 years) the filing of exemption applications by former subordinate organizations. For example, entities could be required to come in with their former group members, based on the parent's employer identification number, location of the parent entity, or first letter of the parent's name.

But many other challenges would remain. The IRS's recent experience with the Form 990-N and the automatic revocation process suggests that it would have to commit a significant amount of its limited resources to outreach and education about the elimination of group rulings. Certain internal systems changes and additional staff in Cincinnati may be needed to accommodate the huge influx of exemption applications. And all

[10] At the very least, the 250,000 existing section 501(c)(3) subordinate organizations would have to file Forms 1023 if group exemptions were eliminated. In addition, members of church group rulings that are not themselves churches, integrated auxiliaries, or conventions or associations of churches will have to file Forms 1023. Also, while entities exempt under other subsections of section 501(c) will not have to file exemption applications for federal tax purposes, any such organization whose state tax exemption is derived from its federal group exemption would have to file at the federal level and then at the state level to retain its state tax-exempt status. Thus, conservatively, we believe that as many as 300,000 or more new exemption applications would be filed with the IRS and require processing if group rulings were eliminated.

Treasury regulations relating to group exemptions would have to be amended (e.g., Treasury Regulations sections 1.508-1(a)(3)(i)(c), 1.6033-1(d), 1.6033-2(d), 1.6043-3(b)(6), 301.6104(a)-1(a), 301.6104(d)-1(f), and 601.201(n)(8)).

It is also very likely that donors will be confused about the status of a subordinate organization during the transition period. Because subordinate organizations have never been listed on Publication 78, we anticipate that donors will have trouble distinguishing between those group members that have lost their exemption for failing to comply with the new group ruling rules, and those which are still exempt under the old group ruling rules because they are still in the transition process.

In summary, the ACT believes that group exemptions should be retained because they significantly lessen the administrative burden on the IRS and group ruling members, they provide an additional level of oversight that would not be present otherwise, and they insure consistent treatment of similarly situated entities. We do recognize that, to some degree, there would be more transparency, accountability, and responsibility if there were no group rulings. But we believe the benefits gained by eliminating group rulings would not justify an incredibly difficult and disruptive transition process for all involved. Instead, as we discuss below, we believe that these benefits can be largely achieved through smaller, more targeted reforms of the current group ruling procedures.

B. Do the current group exemption procedures adequately achieve the tax policy objectives of transparency, accountability and responsibility?

1. Transparency

The concept of transparency relates to the ability of stakeholders – including the IRS, the states, donors, members of the public – to have access to current information about exempt organizations. Ensuring transparency, including access of information to the public, has become one of the most fundamental underpinnings of the law and regulation of exempt organizations at the federal and state level. The ACT believes that there are three aspects of the current group exemption procedures that undermine transparency. The first relates to the ability to file group Form 990 returns. The Form 990 is the principal vehicle for achieving transparency with respect to exempt organizations.[11] Particularly since its redesign in 2008, the Form 990 requires all exempt organizations with a filing requirement to provide detailed information about their operations, activities in the U.S. and abroad, governance, compensation, transactions with related parties, and much, much more.

[11] The ACT notes that the public disclosure of Forms 1023 and 1024 also provides for some level of transparency. However, because those forms are typically filed when organizations are newly formed and have little if any operating history, they are quickly out of date and lack the currency of the Form 990.

While the group exemption procedures do not change the filing requirements for central or subordinate organizations, Treasury Regulations section 1.6033-2(d) allows central organizations to file a group return on behalf of some or all subordinate organizations that elect to file on a group basis. The Form 990 instructions for filing group returns are complex, and make it difficult (and in some cases impossible) for a reader to determine whether individual subordinate organizations are fully compliant with the applicable rules governing their operations.

The lack of transparency associated with group returns clearly has the potential to impede IRS enforcement efforts, because the IRS cannot determine from a group return whether the individual subordinates are in compliance with all relevant tax law requirements. Moreover, the information provided to the ACT by NASCO members confirms that the states have significant difficulty using the information provided in group returns for state regulation and enforcement purposes. Group returns also deprive donors, the public, the media, and other stakeholders of information that, if available, might be important to them in making decisions about grants and contributions, and in gaining a better understanding of the activities, finances, compensation, and governance of the organizations.

The second impediment to transparency relates to the absence of any requirement that central organizations disclose information about the composition of the group, such as a listing of subordinate organizations covered by the group exemption. While most central organizations are required to provide this information to the IRS in an annual filing, there is no requirement for central organizations to make it available to the public, whether on request or otherwise. Also, there is no requirement for central organizations to disclose to the public or the IRS the procedures they follow to exercise on-going general supervision or control over their subordinate organizations. Such information would be of value to the IRS and the states in carrying out their regulatory and enforcement responsibilities, and would also be of interest to the public, the media, and other stakeholders.

The third impediment to transparency relates to the fact that section 501(c)(3) subordinate organizations covered by group exemptions are not listed on Publication 78. The listing, on Publication 78, of exempt organizations eligible to receive deductible charitable contributions provides an important source of transparency for potential donors (including individuals, corporations, grant-makers, and others) who want to confirm that a particular organization is indeed eligible. The IRS has enhanced the utility of Publication 78 to donors by including it on the IRS website in a searchable form, and for many donors the inability to find an organization's name on Publication 78 will result in denial of the contribution or grant. The IRS is aware of the problems that subordinate organizations have in establishing their eligibility to receive deductible charitable contributions, and it issued Publication 4573 partly for that reason. While there is no question that Publication 4573 is helpful in some cases, it has not solved the

problem. Church group ruling holders are particularly frustrated about the inability to convince some donors that their subordinate organizations are exempt under section 501(c)(3). The problem is further compounded for them because many of their subordinate organizations are also not listed on the EOBMF, a document that is also available on-line and can sometimes be used as an alternative vehicle for demonstrating charitable status to prospective donors.

2. Accountability and Responsibility

The concept of accountability relates to the obligation of exempt organizations to operate and use their resources in a manner consistent with their exempt status. Exempt organizations are expected to be accountable to their regulators, including the IRS and the states, as well as to donors and the public. The concept of responsibility is closely related to accountability, and refers to the obligation of exempt organizations to operate in a manner that is consistent with the requirements of their exempt status. Group exemptions fail to encourage the proper exercise of accountability and responsibility in two primary ways.

First, Revenue Procedure 80-27 does not define the level of on-going general supervision or control that a group ruling central organization is expected to exercise. Without such definition, there is likely to be confusion and inconsistency in the level of oversight exercised by central organizations. Second, as noted above, central organizations are not required to disclose, to the IRS, the states, or the public, the procedures they follow in exercising on-going general supervision or control. The absence of such a disclosure requirement makes it difficult to assess the extent to which central organizations are carrying out their responsibilities, or whether the potentially enhanced accountability and responsibility inherent in group exemptions are being achieved. In effect, the IRS has “deputized” central organizations as agents of the IRS, but it has done so without guidance, training, or oversight. In particular, there has been no education or outreach by the IRS to group ruling holders to discuss what constitutes general supervision or control or what are the elements of “best practices” in this area, such as there has been in the past few years regarding governance of exempt organizations. All of these factors have combined to create a situation that is inconsistent with the growing trend in the tax-exempt community toward greater accountability and responsibility. It also creates an environment that can be abused by organizations included in group exemptions.

C. How can the current procedures be revised to enhance such tax policy objectives?

1. Eliminate Group Returns

Eliminating the group return option will greatly enhance transparency for subordinate organizations covered by group exemptions. It will make it easier for the IRS to assess compliance with applicable tax law requirements, and it will address most of the concerns that state regulators have with the group

exemption process. It will also make it possible for all stakeholders (the IRS, the states, donors, the media, and members of the public) to have access to the information required on Form 990 on an individual organization basis, which will be much more useful than the information provided on a group return. We do not believe that eliminating the group return option will significantly increase the Form 990 filing burden on subordinate organizations that formerly filed group returns, because the information required to be provided is the same – it is just the presentation that is different. And this would eliminate an administrative burden on the central organization because it would no longer be required to collect and present the information on a group basis.

2. Update Revenue Procedure 80-27

The ACT believes that the IRS should update Revenue Procedure 80-27. While we appreciate the challenges associated with this task, including the unique issues presented by church group exemptions, the ACT believes that Revenue Procedure 80-27 is no longer sufficient for its intended purpose. A key requirement of Revenue Procedure 80-27 is that the central organization have "general supervision or control" over the subordinate organizations, although that term is left undefined. We believe that the IRS should provide a definition, or at least a framework, for this concept, and we offer some suggestions below. We address this issue as it applies to churches separately, because it will be important for the IRS to develop special group exemption rules in that context. Also, given the large number of stakeholders in the group exemption process, we recommend that the IRS issue an updated version of Revenue Procedure 80-27 in proposed form, for public comment.

a. Define General Supervision or Control

i. In General

In developing a standard for general supervision or control to be exercised by central organizations in a group exemption, it is important to understand the purpose of having such a standard. It is not "supervision or control," *per se*, that is important. What is important is that the central organization has sufficient information about the on-going operations and activities of the subordinate organizations so that it may act to bring non-compliant subordinates into compliance, and if necessary, remove them from the group. The power to remove non-compliant organizations is sufficient leverage, in and of itself, to achieve this goal, provided the central organization has sufficient information about the subordinates. In other words, what is most important is that there are structural mechanisms, reporting processes, or a system of oversight that, on the whole, enables the central organization to sufficiently monitor each subordinate's activities.

One way that a central organization would have sufficient information about its subordinates is for the central organization to have control over the subordinate

organizations' boards or governing bodies. While this situation is probably not all that common in group exemptions, there is little doubt that such a central organization would be in a position to monitor the operations and activities of the subordinates.

But control over the boards or governing bodies of the subordinate organizations is not the only way to achieve the overall goal of the central organization having sufficient information about the subordinates. There are other facts and circumstances that would indicate a central organization is in a position to receive such information. The ACT believes that the IRS should include in a new Revenue Procedure a set of such factors indicating that a central organization is in such a position, i.e., that it is exercising general supervision or control over the subordinate organizations. The following are a list of possible factors that could form the basis of a standard for general supervision or control in group exemptions:

- The central organization appoints a board observer for the subordinate organization.
- The central organization has ownership rights over the property (including rights to the name or logo) of each subordinate organization or requires that the property of each subordinate organization be transferred to the central organization if the subordinate organization leaves or is removed from the group.
- Each subordinate organization has substantially similar articles, bylaws and/or corporate policies.
- The articles and bylaws of each subordinate organization must be approved by the central organization.
- Each subordinate organization must file reports with its central organization at least annually, providing information on basic governance, operations and finances.
- Each subordinate organization that is required to file an annual information return provides its central organization with a copy of the subordinate organization's Form 990, Form 990-EZ, or confirmation that the subordinate organization has filed a Form 990-N.
- Each subordinate organization provides its central organization with a copy of the subordinate organization's annual financial statements, if prepared.
- The central organization has audit rights over each subordinate organization and its operations.

- Significant funding is provided to/from the central organization from/to the subordinate organizations.

- Each subordinate organization has a well-publicized whistleblower policy, with the central organization being the recipient of any whistleblower complaints.

- Each subordinate organization must provide its articles and bylaws to its central organization, notify the central organization if the subordinate organization amends its articles or bylaws, and provide copies of any such amended articles or bylaws.

- Each subordinate organization must notify the central organization if the IRS or other governmental authority audits the subordinate organization.

- Each subordinate organization must notify the central organization if the subordinate organization receives a notice from the IRS or other governmental authority that the subordinate organization failed to file a required form or report, or if such form or report contained incorrect information.

As with any set of factors considered as part of a facts and circumstances test, not all factors are equally important, and a group should not be required to satisfy each factor. On the whole, however, each group must demonstrate adequate general supervision or control in the sense that the central organization has sufficient insight into each subordinate organization's operations and activities.

ii. Churches

The task of formulating an appropriate standard for general supervision or control for church group exemptions is particularly challenging.[12] There are potential Constitutional considerations and certainly practical ones.[13] Nonetheless, we believe there can be a workable standard for church group exemptions — a standard that balances the interests of churches of all polities in having group exemptions and the interests of the IRS in having sufficient transparency, accountability, and responsibility in group exemptions.

We believe there are two key considerations that should inform the development of a standard for general supervision or control for church group exemptions: (1)

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[12] It should be noted that several large church denominations, with tens of thousands of subordinate organizations, received their group exemption rulings prior to Revenue Procedure 68-13, i.e., *before* "general supervision or control" was first introduced as the standard.

[13] We are not Constitutional scholars, and hence, we will not address such matters in any detail in this report. But it is conceivable that the Establishment Clause could be implicated if the requirements to be eligible for the benefits of a group exemption unduly favor non-churches or churches, or some churches over other churches.

recognition that middle-level or "subunits" of a church, rather than just the central organization, can exercise the requisite level of supervision or control over the subordinate organizations, and (2) the requisite level of supervision or control over subordinate organizations should vary depending on the type of subordinate organizations (e.g., churches, integrated auxiliaries of a church, or other church-affiliated organizations).

General Supervision or Control by Subunits of the Church — As a testament to the autonomy granted by the First Amendment, churches are organized in a countless variety of ways, many of which do not fit into a conventional legal or corporate paradigm of supervision or control. At one end of the spectrum are purely hierarchical denominations where one entity has complete control over all the constituent entities of the church. At the other end of the spectrum are purely congregational denominations where the constituent entities share common beliefs, but otherwise operate independently of one another. And there are church polities that lie virtually everywhere between the two ends of this spectrum.

But the important point is the one noted earlier in the discussion of the ABA Exempt Organizations Committee's comments to the IRS regarding Revenue Procedure 80-27. Specifically, because of theological doctrine or practice, many church denominations are prohibited from having one central entity exercise supervision or control (in the conventional legal or corporate sense) over other entities within the denomination. Therefore, there should be another model for general supervision or control in the church group exemption context.

In many church group exemptions, the central organization is not always the "closest" church entity to the subordinate organizations. Instead, there are middle-level or regional "subunits" of the church that exercise more direct supervision or control over the subordinate organizations. For example, the middle-level church entities may own or have an interest in the property held by lower-level church entities. But more significantly, the middle-level entities (or their officials) may exercise religious or ecclesial supervision or control over lower-level church bodies and their leaders (i.e., clergy). And this type of supervision or control can be extremely powerful. Indeed, in some denominations, the clergy leadership of non-compliant subordinate organizations can be summarily removed from their positions by middle-level entities (or their officials) — even in the absence of any corporate board type of control over the subordinate organizations.

In summary, the ACT believes that the centralized, conventional legal or corporate model of general supervision or control simply does not work for church group exemptions. Middle-level entities or subunits of the church should be permitted to provide the requisite level of ongoing supervision or control over the subordinate organizations in church group exemptions. These subunits would then provide the central organization with the basic information necessary

for it to determine whether to remove a particular subordinate organization from the church group exemption.

General Supervision or Control that Varies Depending on the Type of Subordinate Organization — As noted earlier, there needs to be a balance between the interests of churches in having group exemptions and the interests of the IRS in ensuring sufficient transparency, accountability, and responsibility in group exemptions. We believe the best way to strike this balance for church group exemptions is for the requisite level of general supervision and control to vary depending on the type of subordinate organization. Specifically, we believe that there should not be any specified level of general supervision or control over subordinate organizations that are churches, integrated auxiliaries of churches, or conventions or associations of churches.[14] For other types of church-affiliated subordinate organizations, the requisite level of general supervision or control should be similar to the standard required for non-church group exemptions (with subunits of the church, rather than just the central organization, being permitted to exercise the requisite general supervision or control, as discussed above).

There are several reasons for applying this liberal standard for subordinate organizations that are churches, integrated auxiliaries of churches, or conventions or associations of churches. First, this standard would permit virtually all churches, even congregational churches, to have a group exemption covering these types of entities. Second, in many denominational group exemptions, individual local churches (for doctrinal reasons) and integrated auxiliaries (for financial reasons) typically already have a close, oversight-type of relationship with the central organization or some other subunit of the church. Finally, the IRS is not losing any transparency, accountability, or responsibility by having a more liberal standard for these types of subordinate organizations.

On this last point, one concern about section 501(c)(3) group exemptions is that the IRS is delegating to the central organization the determination of whether a given subordinate organization is indeed tax-exempt. But by statute, churches, integrated auxiliaries of churches, and conventions or associations of churches are not required to apply to the IRS for recognition of their exempt status. Also, there is the concern about ongoing monitoring of the operations and activities of subordinate organizations in group exemptions. But again, by statute, churches, integrated auxiliaries of churches, and conventions or associations of churches are not required to file annual information returns to the IRS. Thus, with respect to these types of organizations, the group exemption process does not deprive the IRS of any information it would otherwise have in the absence of group exemptions. Indeed, the application for the church group exemption provides the IRS with more information about these types of subordinate organizations than it

[14] All subordinate organizations in a church group exemption should, however, satisfy an affiliation requirement, i.e., that they share "common religious bonds and convictions." (See IRC section 414(e)(3)(D) where this language is used to define association with a church in the context of church employee benefit plans.)

would have otherwise. The group exemption application provides the IRS insight into the structure, organization, and activities of the subordinate organizations, and assists the IRS in preventing abuse by organizations improperly claiming church status.

In summary, a liberal general supervision or control standard for subordinate organizations that are churches, integrated auxiliaries of churches, or conventions or associations of churches would permit virtually all types of churches to have group exemptions at little or no "cost" to the IRS in terms of losing transparency, accountability, and responsibility. Moreover, because these types of organizations do not file annual information returns, the ongoing oversight provided within the church group exemption is more than what the IRS would be able to do itself. Indeed, this additional level of oversight is one of the advantages of group exemptions, which can be particularly significant in the church context.

As for subordinate organizations other than churches, integrated auxiliaries of churches, or conventions or associations of churches, the calculus of balancing the interests of churches with the interests of the IRS is different. In the absence of group exemptions, many of these types of subordinate organizations would have to file individual applications for recognition of exemption. Thus, in this case, the IRS is deprived of some information about these organizations it would otherwise have in the absence of group exemptions. (On the other hand, some of these church-affiliated subordinate organizations that are not churches, integrated auxiliaries of churches, or conventions or associations of churches are required to file annual information returns.)

In balancing these interests, we believe that the standard for general supervision or control in church group exemptions with respect to subordinate organizations that are not churches, integrated auxiliaries of churches, or conventions or associations of churches should be similar to that for non-church group exemptions. However, because of the unique circumstances presented by church group exemptions, we recommend that the standard allow for consideration of additional facts and circumstances similar to those listed in Treasury Regulations section 1.6033-2(h)(2).

b. Exclude Type III Supporting Organizations

The ACT believes that Type III supporting organizations should be ineligible for inclusion in a group exemption, as is currently the case for private foundations. Changes made by the PPA make this an important issue, since it extended a new set of rules and restrictions on Type III supporting organizations, and on their donors, which are similar to some of the rules applicable to private foundations. Given these changes, donors need to know with certainty whether a particular organization is a Type III supporting organization and, if so, whether it is functionally integrated or non-functionally integrated. The ACT is concerned that the group exemption process does not lend itself to making these

determinations in a manner that is sufficient for donor reliance. We believe that in light of the PPA changes, the IRS's regulatory and enforcement interest in Type III supporting organizations warrants having them apply for recognition of their exemption on an individual basis.

c. Apply the Automatic 12-Month Extension Rule to Group Exemptions

As a technical matter, the ACT believes that sections 4.02.6 and 4.03 of Revenue Procedure 80-27 should be revised to incorporate the automatic 12-month extension rule that applies to organizations applying for recognition of exemption on an individual basis. *See* Treasury Regulations section 301.9100-2. This 12-month extension rule became applicable for individual exemption applications after the group exemption procedures were last revised in 1980. A conforming change should be made to the group exemption procedures.

3. Enhance Form 990 Disclosure for Central Organizations

To enhance transparency for group exemptions, the ACT recommends that all central organizations with some type of Form 990 filing requirement be required to file Form 990, even if they would otherwise be eligible to file Form 990-EZ or 990-N. Moreover, we recommend that all such central organizations be required to disclose, on Schedule O of the Form 990, information about the composition of the group and how the central organization exercises general supervision or control over the subordinate organizations. In addition, the IRS should consider requiring such central organizations to attach to their Form 990 a copy of their annual filing with the IRS that provides an update on the organizations added to and deleted from the group. While we understand that attachments to the Form 990 are disfavored, there would be an offsetting enhancement to transparency that should be taken into account.

4. Donor Reliance

One of the principal concerns that many section 501(c)(3) group exemption holders have is that their subordinate organizations are not listed on Publication 78. This is a frustration for donors as well, since many donors (particularly foundations and corporations) have become reliant on Publication 78 to confirm that prospective donees are eligible to receive charitable contributions. We understand that the IRS has a long-standing policy of including only the central organization, and not subordinate organizations, on Publication 78 and is committed to this position for a variety of reasons. For example, we understand there is concern that the public would assume subordinate organizations appearing on Publication 78 had been granted recognition of exemption by the IRS as part of the Form 1023 application process, rather than under the group exemption procedures. Also, there is a concern that an organization removed from Publication 78 because the central organization deleted it from a group exemption could bring a legal action against the IRS. In addition, there are

concerns with the ability to timely update Publication 78 to reflect additions and deletions of subordinate organizations. And finally, modifying the IRS's computer systems to restructure Publication 78 would involve significant logistical hurdles.

Notwithstanding the IRS's genuine concerns and difficulties, the ACT believes that the inclusion of section 501(c)(3) subordinate organizations on Publication 78 would further the goals of transparency and make it possible for a variety of stakeholders readily to confirm the exempt status of subordinate organizations. Publication 78 is intended, first and foremost, as a service to donors to facilitate the making of contributions to qualified section 501(c)(3) organizations. The fact that donors lack this service with respect to more than 250,000 section 501(c)(3) organizations (not counting 100,000 – 150,000 churches) that have recognition of exemption under the group exemption procedures is a source of concern to subordinate organizations and their donors. We understand that this is a source of concern to the IRS as well, which is one reason it issued Publication 4573. But group exemption holders have told the ACT that while Publication 4573 is helpful in some cases, it is not sufficient to address the problem.

If it is not possible to include subordinate organizations on Publication 78, the ACT recommends that the IRS work with affected organizations to consider additional ways to enhance the reliance by donors on the section 501(c)(3) status of subordinate organizations covered by group exemptions. Possible options might include the following:

(1) Make sure that all church group exemption holders are aware that the IRS will input and update information about their subordinate organizations on the EOBMF if that information is provided in the required format. Work with churches that are interested in this option to develop a process for obtaining and inputting such information.

(2) Have a separate "group exemption" page on the IRS website that includes a list of central organizations and their subordinates (to the extent the IRS has such information) with an explanation that the subordinates received recognition of exemption under the group exemption procedures and confirmation that donors can rely on such exemption. Also include an explanation of how donors may search the EOBMF for names of subordinate organizations, and explain that in the case of subordinate organizations under church group exemptions, they may not be included on the EOBMF.

(3) Include a list of the names and contact information (including Internet address) of central organizations on a separate "group exemption" page of the IRS website, with an explanation of the group exemption procedures and confirmation that donors may rely on information they receive from the central organizations as to the exempt status of their subordinate organizations.

VII. Recommendations

The ACT believes that group exemptions should be retained, but that the current group exemption procedures could be revised to achieve greater transparency, accountability and responsibility. Our recommendations may be summarized as follows:

1. Allowing group exemption holders to file group Form 990 returns does not provide the IRS, the states, or the public with adequate transparency about the activities of subordinate organizations covered by a group exemption, or serve as a mechanism to promote adequate accountability by the subordinate organizations on an individual basis. We recommend eliminating group returns by amending Treasury Regulations section 1.6033-2(d) to remove the authority of central organizations to file group returns.

2. Revenue Procedure 80-27 does not define or explain how central organizations are expected to exercise on-going general supervision or control over their subordinate organizations. This lack of guidance makes it difficult for group exemption holders to exercise appropriate responsibility with respect to their subordinate organizations and creates a lack of accountability in meeting unstated and unknown expectations. We recommend updating Revenue Procedure 80-27 to provide such guidance and that the revision be issued in proposed form for public comment. As part of this process, special consideration should be given to the development of appropriate standards to address the varied organizational structures and unique legal status of churches.

3. Group exemption holders are not required to disclose to the public their list of subordinate organizations or any other information about the composition of the group. Nor are they required to disclose to the public or the IRS the procedures they follow to exercise on-going general supervision or control in compliance with Revenue Procedure 80-27. This disclosure vacuum contributes to a lack of transparency and accountability with respect to group exemption holders. We recommend requiring group exemption holders that have a Form 990 filing requirement to disclose, on Schedule O of the Form 990, information about the composition of the group and how the central organization exercises general supervision or control. To ensure that all groups provide this disclosure, we recommend that each central organization with a Form 990 filing requirement be required to file Form 990, even if it would otherwise be eligible to file Form 990-EZ or 990-N.

4. While section 501(c)(3) subordinate organizations covered by group exemptions are generally listed in the Exempt Organizations Business Master File (EOBMF), they are not listed in Publication 78, making it impossible for donors to verify readily the ability of section 501(c)(3) subordinate organizations to receive tax-deductible charitable contributions. Recent IRS efforts to educate donors about their ability to rely on group exemption confirmations given by the central organization, while appreciated by the sector,

have met with mixed success at best. We recommend that the IRS work with section 501(c)(3) group exemption holders, including churches, to develop workable new options for including subordinate organizations in Publication 78 or otherwise providing donors with additional information regarding the deductibility of contributions that exists for other tax-exempt charities.

5. Changes made by the PPA in the definitions and tax laws governing section 509(a)(3) supporting organizations raise a question as to whether it continues to be appropriate for them to be included in a group exemption ruling. On balance, we believe that "Type III" supporting organizations should not be included in a group exemption ruling. We recommend that this be addressed as part of a project to issue an updated version of Revenue Procedure 80-27 for public comment.

6. Finally, we recommend that there be a significant transition period for existing groups to come into compliance with any changes to the group ruling procedures. Moreover, special consideration should be given to existing church group exemptions, as they are some of the largest and oldest of all group exemptions. (Some church group exemptions have tens of thousands of subordinate organizations and some have been in place for 60 years or more.) We recommend the IRS seek comment from existing group exemption holders before setting any time limits for a transition period.