

A. GROUP EXEMPTION PROCESS

1. Introduction

The issuance of group exemption letters is an administrative procedure which has been in existence for several decades. The procedures were instituted to relieve the Service from the burden of individually processing a large number of applications involving the exempt status of organizations that are affiliated with each other, and also are organized and operated for the same purpose. This topic will focus on the granting of an initial group exemption letter.

The procedures for obtaining and maintaining a group exemption letter are contained in Rev. Proc. 80-27, 1980-1 C.B. 677, and IRM 7667. For a discussion of the establishment of a group exemption on the Exempt Organizations/Business Master File, see IRM 7820.

2. What is a Group Exemption Letter

A group exemption letter is a ruling or determination that is issued to a central or parent organization (generally, a state, regional, or national organization) which holds that one or more subordinate organizations (usually a post, unit, chapter, or local) are exempt from federal income tax by virtue of being subordinate organizations of a central or parent organization.

The basic distinction between a group exemption letter and an individual letter is simply that the subordinates are not required to furnish the Service with individual documentation to support each of their claims for exemption. Instead, the parent will attest that the subordinates are organized and operated as described in the paragraph under which the exemption is sought. (A more detailed discussion will follow with respect to the certifications that a parent must submit to the Service before a subordinate is included in a group exemption.)

Regardless of whether an organization is included in a group exemption or whether it has received an individual exemption letter, all organizations are subject to the same rules for maintaining their tax-exempt status. Likewise, all exempt organizations, except IRC 501(c)(1) organizations, are subject to the tax on unrelated business income under IRC 511. Therefore, the main advantage of a group exemption letter is that each subordinate organization is relieved from filing

its own application for recognition of exemption. Additionally, subordinates may be included in certain group returns.

3. Who May Obtain a Group Exemption Letter

An organization seeking a group exemption letter must first obtain recognition of its own tax-exempt status under IRC 501(a) by filing the appropriate application for recognition of exemption as outlined in Rev. Proc. 84-46, 1984-1 C.B. 541. Providing the organization satisfies the requirements of the particular paragraph under which the exemption is being sought, and is not classified as a private foundation, it may obtain a group exemption letter if it has one or more subordinate organizations under its general supervision or control. (An organization described in IRC 521 may not obtain a group exemption.)

4. Who May Be Included in a Group Exemption Letter

Assuming a parent organization has established that it is entitled to exemption, a group exemption letter may be issued for subordinates which the parent certifies will be organized and/or operated according to sample documents submitted to support exemption.

An organization may not hold more than one exemption letter. If an organization was previously issued an individual exemption letter, and requests to be included in a group exemption letter, the outstanding individual exemption will be superseded. In this connection, the parent is responsible for notifying the subordinate that its prior individual exemption letter has been superseded.

Parents may obtain a group ruling for subordinates described in a paragraph of IRC 501(c) other than the subsection under which the parent has obtained exemption. For example, an IRC 501(c)(3) parent may have a group arrangement involving subordinates that are engaged in IRC 501(c)(4) social welfare activities. An instrumentality or an agency of a political subdivision that establishes that it is a qualified governmental agency and that it exercises control or supervision over more than one organization with similar purposes and operations may, in the same manner as an IRC 501(c) central organization, obtain a group exemption covering those organizations even though the agency may not have an IRC 501(c) exemption. Subordinate organizations that fall within this category are generally federal credit unions, state chartered credit unions and federal land bank associations.

In order for a subordinate to be included in a group exemption letter the parent must establish that the subordinate is (1) affiliated with it; (2) subject to its general supervision or control; (3) exempt under the same paragraph of IRC 501(c) as all other subordinates IRC 501(c) (but in some instances not necessarily the same paragraph of IRC 501(c) under which the parent is exempt); (4) other than a private foundation or a foreign organization; and (5) on the same accounting period as the parent. In addition, if the subordinates are described in IRC 501(c)(3), and are subject to the requirements of IRC 508(a), they must be formed within the 15-month period prior to the submission of the request for the group exemption letter if they wish to be recognized from their dates of creation. If, however, one or more of the subordinates was not organized within the 15-month period, a group exemption letter may still be issued providing all of the subordinates are willing to be recognized from the date the application for a group exemption letter was filed. Providing the subordinate meets the five-factor test above, it must then provide the parent with written authorization if it wishes to be included in the application for a group exemption letter.

5. Information Required for a Group Exemption Letter

To obtain a group exemption letter, a parent must follow the procedures outlined in Rev. Proc. 80-27. The revenue procedure provides that the parent must submit certain information on behalf of the subordinates and that information must include a letter signed by an authorized representative that the subordinate has met the foregoing five-factor test. In addition, the following representations must be submitted over the signature of an authorized representative of the parent:

- (a) a detailed description of the principal purposes and activities of the subordinates, including financial information;
- (b) a sample copy of the subordinates' uniform governing instrument which has been adopted by the subordinates (alternatively, a representative instrument may be submitted);
- (c) an affirmation that the subordinates' purposes and activities are as set forth in the representations furnished in (a) and (b) above;

- (d) a statement that each subordinate has furnished a written authorization to be included in the group exemption letter; and
- (e) a list of the subordinates who have been previously recognized as exempt from federal income tax.

In addition to the information required above, if the application involves a group exemption letter under IRC 501(c)(3) and the subordinates are subject to IRC 508(b), the parent must furnish a statement to the effect that no subordinate to be included in the group exemption letter is a private foundation as defined in IRC 509(a).

For any subordinate that is a school, the parent must furnish information to show that the subordinates have complied with the nondiscriminatory policy as to the admission of students as required by Rev. Proc. 75-50, 1975-2 C.B. 834. The parent must also include a statement to the effect that the subordinate meets the requirements of Rev. Rul. 71-447, 1971-2 C.B. 230, which provides that a private school that does not have a racially nondiscriminatory policy as to students does not qualify for exemption.

The parent must submit a complete list of the names, complete mailing addresses, and the employer identification numbers of all subordinates to be included in the group exemption letter. A parent may furnish a compilation of its subordinates to be included in the group exemption letter in any form providing it contains all the information required. However, if a directory is furnished and it includes the names of organizations other than the subordinates to be included in the group exemption letter, the parent must identify those organizations that are not to be included.

6. Denial of a Group Exemption Letter

If an organization is denied a group exemption letter because of failure to meet the requirements of Rev. Proc. 80-27 rather than for failure to meet the requirements of the paragraph under which the exemption is sought, the parent's application should be ruled on as if it were a request for an individual exemption letter. The exemption letter must state that the subordinates are not included and that if a subordinate desires to establish its exempt status, it must file an individual application with its key district director. In this connection, the usual protest and

conference rights would be afforded before the exemption letter is finalized including IRC 7428 rights in IRC 501(c)(3) cases.

If the request for a group exemption letter is denied on the basis that the parent organization does not qualify for exemption on the merits, a denial letter will be prepared, and the organization will be afforded the usual protest and conference rights. The letter should also state that because the parent organization is not exempt the group exemption cannot be approved.

If the parent satisfies all the procedural and substantive requirements for a group exemption letter, but it appears that one or more of the subordinates may not qualify, the parent should be advised in writing. If the parent is unable to provide a written submission of evidence that the subordinate should be included in the group exemption letter or is unable to clarify the matter at a conference, the group exemption letter should be issued without the inclusion of the questionable subordinates. In this situation, the parent could not protest the exclusion of individual subordinates.

7. Termination/Revocation of Group Exemption Letter

A termination of a group exemption letter occurs if a parent (1) dissolves or ceases to exist, (2) fails to submit the annual information required by Rev. Proc. 80-27, or (3) fails to file the required annual information return or any other reporting requirement as required by IRC 6033. If a termination occurs, recognition of the tax-exempt status of the subordinates will cease and each subordinate, providing continued exemption is desired, must file an application for recognition of exemption on its own.

Likewise, a subordinate's tax-exempt status will be affected if the parent's tax-exempt status is revoked by the Service. If the parent fails to continue to meet the requirements for tax-exempt status, subordinates will no longer be recognized as exempt unless each subordinate establishes its own recognition of exemption.

A subordinate may also be terminated or revoked. With respect to the termination of a subordinate's tax-exempt status, the parent is obliged to notify the Service that a subordinate no longer meets the requirements for inclusion in the group exemption letter. Generally, a parent notifies the Service of these terminations when the annual information required by Rev. Proc. 80-27 is filed.

If the Service examines a subordinate and concludes that it no longer qualifies for exemption, the subordinate will receive a letter of revocation. The Service will then notify the parent that the group exemption letter does not apply to the particular subordinate. In this connection, the subordinates will be afforded the usual protest and conference privileges as would be offered to the parent organization if the parent's tax-exempt status was revoked.

If the revocation involves an IRC 501(c)(3) exemption letter, the parent or the subordinate, as the case may be, should be informed of the declaratory judgment provisions of IRC 7428.

8. Group Returns

Providing the tax-exempt status of the subordinates has been established under a group exemption letter, Reg. 1.6033-2(d) provides that the parent, although required to file a separate annual return for itself, may elect to file a group return covering at least two or more of its subordinates. The filing of a group return is in lieu of the filing of a separate return by each of the subordinates that would otherwise be required to file. Subordinates electing to be included in a group return, Form 990, Return of Organization Exempt From Income Tax, must meet the five-factor test discussed earlier in this topic. A group return, however, cannot be filed to report unrelated business income. Subordinates that are subject to the tax on unrelated business income must file their own Form 990-T, Exempt Organization Business Income Tax Return. IRM 7820 contains a detailed discussion on the procedures relating to the filing of a group return.

A group return must include only those subordinates that have authorized the parent in writing to include them in the return. An authorized officer of each subordinate must also provide to the parent a statement under the penalties of perjury specifying its gross income, receipts, and disbursements, and such other information relating to them that must be included on the return.

The group return must be filed on the basis of the annual accounting period of the central organization. Therefore, only those subordinates who keep their books on the same accounting period as the parent may be included on the return.

The subordinates' information may be provided in one of two ways. Either the information may be provided on the parent's Form 990 with separate schedules attached for the subordinates, or on a consolidated basis for all the subordinates and the parent on one group return. The return must indicate which method is

being used to report the information. The method selected must be used for all subsequent filings unless the parent obtains the consent of the Commissioner to change the method of reporting.

9. Conclusion

Even though the issuance of a group exemption letter is a convenience for the Service, and substantially decreases the individual consideration of a large number of applications, it probably increases the number of entities subject to our examination program. In this regard, examination specialists may employ the same procedures and techniques in reviewing the returns and/or activities of parents and subordinates. See IRM 7(10)64 for a detailed discussion regarding the coordination of examinations involving parents and subordinates.