

New Procedure For Nonprofit Organizations That Automatically Lost Their Exempt Status Under Section 501(C)(3)

On January 3, 2014, the IRS announced a new procedure for nonprofit organizations that automatically lost their exempt status under Section 501(c)(3) because they failed to file some version of the Form 990 for three consecutive years.

A. Background

As you may recall, since 2008, the Internal Revenue Code has required that Section 501(c)(3) organizations file a version of the Form 990 every year. (Only certain religious organizations are exempt from the requirement.) If an organization fails to file a Form 990 for three consecutive years, the organization's tax-exempt status is automatically revoked.

There are three versions of the Form 990 that apply to public charities – Form 990-N, Form 990-EZ and Form 990. (Private foundations file Form 990-PF.) Which form the organization should file is based on its size, as illustrated by the following chart:

	<i>Form to File</i>
Gross receipts normally \leq \$50,000 Note: Organizations eligible to file the 990-N e-Postcard return may choose to file a full return.	990-N e-Postcard return filed electronically through the IRS website.
Gross receipts $<$ \$200,000, and Total assets $<$ \$500,000	990-EZ or 990
Gross receipts \geq \$200,000, or Total assets \geq \$500,000	990

Starting in 2012, the IRS began revoking the tax-exempt status of those organizations that had not filed a return for the years 2008, 2009 and 2010. Each month the IRS publishes a list of the organizations that have failed to meet the three year requirement either initially or in subsequent three-year periods. To date, tens of thousands of organizations – many of them inactive – have lost their exempt status for failing to file their returns. In 2012, the IRS announced a special program to allow smaller nonprofits to regain their exempt status retroactively but that program expired on December 31, 2012.

B. What Has Happened to an Organization That Lost Its Exempt Status?

Prior to Revenue Procedure 2014-11, an organization that lost its exempt status was subject to federal income tax on any income it earned once its exempt status had been revoked. In addition, its donors could not claim a tax deduction for contributions to the organization. The IRS regularly publishes a list of organizations that have lost their status, and from the date the organization appears in the revocation list, no donor deductions are allowed. The organization has also been liable to the IRS for penalties for failure to file the Form 990. The penalties equal \$20 per day, up to a maximum of \$10,000 for each return not filed. Finally, a private foundation cannot include a grant to a non-exempt organization in its

calculations to determine if it has met the minimum charitable distribution requirements applicable to private foundations.

In order to regain its exempt status, an organization has had to refile a Form 1023 with the IRS setting forth why it met the requirements of Section 501(c)(3). It had to pay the application filing fee (\$400 or \$850, based on the organization's size). Unless the organization could show that it failed to file its Form 990s for reasonable cause, its reinstatement was not retroactive to the date of revocation, but was effective only as of the date the new application was filed. Moreover, the loss of exempt status did not relieve an organization of its obligation to file the Form 990. The organization still had to file the form for those years for which it had not filed a return.

These rules were harsh, especially for small nonprofits. As a result, the IRS has released a new procedure that will ameliorate some of the more severe consequences of the automatic revocation. Under Revenue Procedure 2014-11, the IRS now classifies these organizations into three categories:

1. Small nonprofits that refile for exempt status within 15 months of loss of exempt status;
2. Other nonprofits that refile for exempt status within 15 months of loss of exempt status; and
3. Nonprofits that refile for exempt status more than 15 months after loss of exempt status.

C. Revenue Procedure 2014-11 Relief for Small Organizations

A small organization is a nonprofit that was eligible to file either a Form 990-N or a Form 990-EZ in each of the three consecutive years it failed to file a return. This includes any organization that in each of the three years had either:

1. Annual gross receipts of less than or equal to \$50,000; or
2. Annual gross receipts of more than \$50,000 and less than \$200,000 and total assets of less than \$500,000.

A small nonprofit that has not previously lost its exempt status for failing to file its Form 990s will have its tax-exempt status reinstated retroactively to the date its status was revoked if it files for reinstatement with the IRS within 15 months after it lost its status. In order to file for reinstatement, the nonprofit must complete a new Form 1023 application for exemption and pay the filing fee. The IRS recommends that the nonprofit write "Revenue Procedure 2014-11, Streamlined Retroactive Reinstatement" on the top of the application.

For purposes of this rule, the 15 month period begins on the later of:

1. The date the IRS issues a letter notifying the organization of the loss of its exempt status (the "Revocation Letter"); or
2. The date the IRS first publishes notice of the organization's loss of exempt status (the "Revocation List").

An organization that has not received an IRS Revocation Letter should not assume that the 15 month period has not started. There is a good chance that the IRS does not have the organization's current mailing address. In which case, the IRS may have issued a Revocation Letter without the organization receiving it. Therefore, the organization may want to file its application for reinstatement within 15 months of the date it first appears on the Revocation List, to ensure that its application is filed on time.

Once the IRS grants the reinstatement, the organization must file any Form 990-EZs that it previously failed to file. (An organization that was eligible to file the Form 990-N is not required to file back returns.) The IRS will waive any penalties for the failure to file.

There are many benefits to following this procedure. First, the organization will not be subject to federal income tax for the time its tax-exempt status was revoked. It is also not subject to penalties for failure to file the Form 990. Its donors can continue to claim a tax deduction for contributions made to the organization prior to its reinstatement and a private foundation can include any grants made to the organization in its calculation of charitable distributions.

D. Revenue Procedure 2014-11 Relief for Larger Organizations

Larger organizations may also apply for retroactive reinstatement of their exempt status. If the organization files within 15 months of the loss of its exempt status, it should follow the same procedures used by small organizations, with two critical changes:

1. It must file all of its past due Form 990s, including any Form 990s that were due after it lost its exempt status, prior to filing its application for reinstatement; and
2. It must show there was reasonable cause for its failure to file its Form 990 ***for at least one of the three years in question.***

The IRS has stated that in order to establish "reasonable cause," an organization must show that it exercised ordinary business care and prudence in attempting to comply with the IRS reporting requirements.

In determining whether the organization has established reasonable cause, the IRS will take into account all pertinent facts and circumstances. The following factors weigh in favor of finding reasonable cause. The IRS has stated that the organization does not have to satisfy all of these factors, and that no single factor is determinative:

1. The organization's failure was due to its reasonable, good faith reliance on erroneous written information from the IRS;
2. The failure to file the return arose from events beyond the organization's control that made it impossible for the organization to file a return for the year;
3. The organization has an established history of complying with its Form 990 reporting requirements and any other applicable reporting or other requirements under the Internal Revenue Code; and

4. The organization acted in a responsible manner by undertaking significant steps to avoid or mitigate the failure to file the required return and to prevent similar failures in the future, including, but not limited to—
 - a. Attempting to prevent an impediment to filing or a failure to file, if it was foreseeable;
 - b. Acting as promptly as possible to remove an impediment or correct the cause of the reporting failure, once it was discovered; and
 - c. Implementing safeguards designed to ensure future compliance with the reporting requirements.

If the organization is successful in its application for retroactive reinstatement, the IRS will waive any penalties for the organization's failure to file its Form 990s in a timely manner.

E. Revenue Procedure 2014-11 Relief Once 15 Months Has Passed

Once the 15 month period has passed, an organization may still apply for retroactive reinstatement, but only if it can demonstrate reasonable cause for why it failed to file the Form 990 **for all three years**. If the organization cannot satisfy this requirement, it may still file for reinstatement. Once granted, the reinstatement will be effective as of the date the organization files its application for reinstatement (the "Post-Mark Date").

F. Effective Date of Revenue Procedure 2014-11 and Its Impact on Pending and Past Applications

Revenue Procedure 2014-11 is effective for applications submitted after January 2, 2014. To the extent the revenue procedure benefits an organization's ability to have its tax exempt status retroactively reinstated, the IRS will apply this revenue procedure to applications that it has already received and are pending.

A small organization that had already received reinstatement of its tax-exempt status prior to January 2, 2014, and that would have met all of the requirements for **retroactive** reinstatement, will be treated as if it had been reinstated retroactively from the date its tax exempt status was revoked. The organization should keep its determination letter reinstating its tax-exempt status and a copy of the revenue procedure with its books and records.

An organization that applied for and received reinstatement of its exempt status prior to the effective date of the revenue procedure, and that:

1. Would have satisfied the retroactive reinstatement requirements for larger organizations that filed for reinstatement within 15 months of its loss of status; or
2. Would have satisfied the retroactive reinstatement requirements for organizations that filed after the 15 month period,

may reapply for **retroactive** reinstatement if it meets the requirements of Revenue Procedure 2014-11. The organization should submit a copy of the application it previously filed to receive reinstatement and any other materials required by Revenue Procedure 2014-11 on or before May 2, 2014. The IRS will waive the user fee. In addition, the organization should include with its copy of its previous application, a copy of its determination letter reinstating its tax-exempt status.

If you have any questions about Revenue Procedure 2014-11, contact

Regina Hopkins
Assistant Director for
Community Economic Development
DC Bar Pro Bono Program
1101 K Street N.W.
Suite 200
Washington, DC 20005
202-737-4700, Ext.3376
Fax: 202-626-3474
rhopkins@dcbar.org

You can also visit the DC Bar Pro Bono Program for more information at www.lawhelp.org/dc/ced