

Notifying the IRS and State Agencies When Restructuring your Organization

Most nonprofits that have received an exemption from income tax understand that the basis on which the IRS determination was made were the facts and circumstances included in the original application submitted to the IRS for review and approval. Logically, it would seem that most organizations would understand that if the basis upon which the exemption was granted changed the exemption could no longer be relied upon. And they would be correct.

IRS *Rev. Proc. 2018-5* (as modified by IRS *Rev. Proc. 2018-10*) describes the requirements for obtaining a determination from the IRS of tax exempt status. And Section 11.02 of IRS *Rev. Proc. 2018-5* specifically notes that any such previous determination may no longer be relied upon if there is a material change of facts, inconsistent with the exemption, in the character, purpose, or method of operation of the organization.

Thus, it is incumbent on the nonprofit to notify the IRS when such changes occur and to petition them for a new exemption ruling based upon the changes made. Generally, this meant filing a new application for exemption. However, new rules recently put in place by the IRS has reduced the compliance burden on certain types of tax exempt organizations who make a change to their mission or reason for existence. For qualifying, domestic organizations exempt under Code Sec. 501(c) the IRS will now generally allow a change in their form or state of organization without requiring a new application for exempt status.

Here's what you need to know. Effective January 1, 2018, the corporate restructuring of a domestic business entity that is (a) classified as a corporation under Reg. §1.7701-2(b)(1) or (2) (which most churches and religious corporations are), and (b) recognized as exempt under Code Sec. 501(a) as an organization described in Code Sec. 501(c), will not be required to file a new application for exemption from tax for the surviving organization so long as the surviving entity is carrying out the same purposes the exempt organization had been involved in when it engaged in the restructuring. The organization must be in good standing at the time of reorganization with the IRS and the state in which it is incorporated or formed (if an unincorporated association), and must continue to satisfy the organizational test described in Reg. §1.501(c)(3)-1(b)¹. There are exceptions to the new rules of course², but generally this means that churches and religious organizations need only notify the IRS of the change for the federal exemption to continue.

The rules for notifying state and local agencies can vary so it is important to check with each agency individual that has any oversight responsibilities (i.e. Secretary of State, Attorney

¹ <https://www.law.cornell.edu/cfr/text/26/1.501%28c%29%283%29-1>

² Excepted from this updated procedure are corporate restructurings in which the resulting organization is a disregarded entity, limited liability company, partnership, or foreign business entity, or the surviving entity obtains a new employer identification number. Any such surviving entity that desires exempt status under Code Sec. 501(a) must apply following the procedures detailed in Rev. Proc. 2018-5.

General, Board of Equalization, Corporation Commissions, County Assessor, etc.) to ensure any change in activities will not impact your exemption(s) or reporting requirements.

DISCLAIMER

This material is presented with the understanding that the author is providing basic information only and assumes no liability whatsoever in connection with its use. Tax laws are constantly changing, are subject to differing interpretations, and the facts and circumstances in any particular situation may not be the same as those presented here. Therefore, we urge you to do additional research and make sure that you are fully informed and knowledgeable before using the information contained herein.

To ensure compliance with Treasury Regulations (31 CFR Part 10, §10.35), we are required to inform you that any tax advice contained in any correspondence or other communication from us is not intended or written by us to be used, and cannot be used by you or anyone else, for the purpose of avoiding penalties imposed by the Internal Revenue Code.