

IRS REVENUE PROCEDURE PROPOSAL LIMITS ELIGIBILITY FOR GROUP EXEMPTION

June 16, 2020

Some tax-exempt health systems have obtained a group exemption to assist with filing a consolidated tax return and with adding additional subordinate organizations to their group exemption based upon a Revenue Procedure from 1980. Forty years later, the IRS proposes to update the group exemption letter program. The new updates will limit availability of a new group exemption to some complex health systems. Although there are many updates included in the proposal, the purpose of this advisory is to describe some of the more significant changes to the program.

The IRS issued [Notice 2020-36](#) containing a proposed revenue procedure for the group exemption letter program. The proposal clarifies and provides updated procedures under which subordinate organizations described in § 501(c) of the Internal Revenue Code, affiliated with and under the general supervision or control of a central organization described in the same paragraph of § 501(c), may obtain exemption from federal income tax. The purpose of the proposal is to reduce the administrative burden and increase the efficiency of the program, to improve the integrity of data collected for purposes of program oversight, to increase the transparency of the program, and to increase compliance.

The IRS requests comments on all aspects of the proposed revenue procedure, including applicable grandfather and transition rules, on or before August 16, 2020. The proposed revenue procedure would modify and supersede [Rev. Proc. 80-27](#). Until publication of the final revenue procedure, Rev. Proc. 80-27 continues to apply. Please note that the IRS will not accept any requests for group exemption letters beginning June 17, 2020, until publication of the final revenue procedure or other guidance.

CENTRAL ORGANIZATION REQUIREMENTS

The proposal sets forth updated procedures for central organizations to maintain a group exemption letter including:

- A central organization must have at least five subordinate organizations to obtain a group exemption letter and at least one subordinate organization to maintain the group exemption letter thereafter.
- A central organization may maintain only one group exemption letter.
- A central organization must establish that each subordinate organization to be included in the group exemption letter is affiliated with the central organization and is subject to its general supervision or control. The proposed revenue procedure provides definitions of affiliation, general supervision, and control to clarify this rule.
- A central organization must submit the supplemental group ruling information at least 30 days prior to the close of its annual accounting period (rather than the previous 90-day requirement). The central organization must also notify the IRS of any subordinate organizations that are no longer included in the group because of an automatic revocation.

SUBORDINATE ORGANIZATION REQUIREMENTS

The proposed revenue procedures provide four new requirements that a subordinate organization must meet for initial inclusion in or subsequent addition to a group exemption letter:

- All subordinate organizations must be described in the same paragraph of § 501(c) as the central organization.
- If the subordinate organizations are described in § 501(c)(3), all such subordinate organizations must be classified as public charities under the same paragraph of § 509(a).
- All subordinate organizations described in § 501(c) (other than § 501(c)(3)) must be described by the same National Taxonomy of Exempt Entities Code.
- All subordinate organizations must adopt a uniform governing instrument.

The proposed revenue procedure sets forth that the following organizations are not eligible for inclusion as a subordinate organization:

- An organization that is organized outside of the United States (unless the organization is formed in the United States and operates in a foreign country).
- An organization described in § 501(c)(3) that is classified as a private foundation under § 509(a).
- An organization described in § 501(c)(3) that is classified as a Type III supporting organization under § 509(a)(3) or a qualified nonprofit health insurance issuer described in § 501(c)(29).
- A subordinate organization that has had its exemption automatically revoked and has not yet had its exemption reinstated after filing an application.

A subordinate organization is still required to authorize the central organization to include it in the group exemption letter request. However, the authorization must also permit the central organization to remove the subordinate organization if the subordinate organization fails to comply with the requirements of the proposed revenue procedure.

APPLICABILITY

The proposed revenue procedure will apply to group exemption letters requested and issued after the date the final revenue procedure is published and, except as provided below, to preexisting group exemption letters. However, the requirements that a central organization have at least one subordinate organization to maintain a group exemption letter and that the central organization maintain only one group exemption letter will apply after a one year transition period.

Although the proposed revenue procedure will apply to preexisting subordinate organizations, there are some exceptions, generally including the following definitions and rules which will not apply to preexisting subordinate organizations:

- The definitions of “general supervision” or “control.”
- The four new requirements that a subordinate organization must meet for initial inclusion in, or subsequent addition to, a group exemption letter.
- The limitation applicable to Type III supporting organizations.
- The requirement that the authorization for initial inclusion in, or subsequent addition to, a group exemption letter permit the central organization to remove a subordinate organization in certain circumstances.

ANALYSIS

Group exemption is not meant for all organizations – there are pros and cons to pursuing this structure for tax-exempt health systems and other organizations. The proposed rules have the effect of limiting the availability of group exemption to some new applicants. Contact a member of Hancock Daniel's [Tax-Exempt Status](#) team for assistance with reviewing your organization's eligibility for group exemptions under Notice 2020-36, assessing potential options, and providing compliance guidance for existing group exemptions.

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