
Automatic Revocation of Nonprofits' Tax-Exempt Status

*What Nonprofits, Grantmakers,
and Donors Need to Know*

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Note: These materials are intended to provide only a general summary and overview of this topic as it pertains to nonprofits that have been granted tax-exempt status under the Internal Revenue Code. These materials are not to be considered legal advice applicable to any particular situation, and organizations and individuals needing specific advice and counsel on these matters should always consult with knowledgeable counsel.

Introduction

So are there really close to 2 million tax-exempt organizations operating in the United States—or not? Soon we will be closer to a more accurate picture of the sector.

For decades, once an organization received its determination from the IRS as tax exempt, that status was final—it remained in effect unless affirmatively revoked by the IRS.¹ Although hundreds of thousands of nonprofits had to file an annual information return (Form 990, 990-EZ, or 990-PF) with the IRS, a significant number failed to do so, and the majority of exempt organizations were not required to file because they did not meet filing thresholds.

For many years, these non-reporting organizations remained listed as tax exempt, but it was unclear whether they were active and didn't meet the reporting thresholds, met the reporting thresholds but neglected to file, or were in fact no longer operating (had merged, achieved the mission, or not, and/or stopped activities). When IRS attempts to contact non-reporting organizations went unanswered, the only recourse available to the IRS was to revoke those organizations' tax-exempt status. The IRS was reluctant to take this step.

The situation changed with the passage of the Pension Protection Act in 2006. Among the law's numerous provisions was a new requirement for almost all exempt organizations to file information

with the IRS annually, starting in 2008 for activities from January 1, 2007, on. And the IRS is now *required* to revoke the tax exemption of any organization required to file that doesn't do so for three consecutive years. Revocations will affect not only the organizations that lose their exemptions but also the donors and funders that support them and the audiences that rely on their services.

Just How Many Tax-Exempt Organizations Are at Risk?

In a word—lots! Some nonprofits still are not required to file, including religious congregations and state institutions.² But the remaining exempt organizations now must submit a return to the IRS each year. The IRS created a new form, Form 990-N, for smaller organizations that previously did not meet the thresholds to file. See the appendix for more information about Form 990-N and the mechanics of filing it.

In April 2010, as the first filing deadline that would trigger automatic revocations drew near, GuideStar analyzed the IRS Exempt Organizations Master File (also known as the Business Master File or BMF) to determine how many organizations might be at risk. The April BMF listed more than 1.3 million exempt organizations required to file an annual return with the IRS. Of that number, more than 373,000 had never filed, and another 73,000 were at least three years in arrears with their filings.

What Does “Revocation of Tax-Exempt Status” Mean?

May 17, 2010, was the first filing deadline that led to automatic revocations. At the end of the following month, the Urban Institute’s National Center for Charitable Statistics (NCCS) estimated that almost 300,000 small nonprofits had not yet completed the 990-N and were in jeopardy. Fifty-eight percent of the organizations were 501(c)(3) public charities. The remaining nonprofits at risk were tax exempt under other 501(c) subsections. The NCCS estimates that about 16,000 additional organizations are part of a group return; these organizations are not required to file if their national offices file on their behalf.

In July 2010, more than 355,000 nonprofits appeared to be facing revocation. A new NCCS report found that more than 292,000 small nonprofits still need to file Form 990-N.³ GuideStar’s analysis of the July 2010 BMF revealed that more than 63,000 larger nonprofits have failed to file a Form 990, 990-EZ, or 990-PF during the past three years.

Organizations that registered with the IRS between 2008 and 2010 still have time to file within the three years and are not yet subject to revocation.

What Does “Revocation of Tax-Exempt Status” Mean?

Revocation has a drastic and expensive impact on a nonprofit. If it’s a charitable organization, it will no longer be able to accept tax-deductible contributions. Whatever type of exempt organization it is, it will need to pay federal income taxes. It may also incur penalties for failure to pay income taxes, to say nothing of the loss of the trust of its donors, members, and clients. Plus, most grantmakers (such as private foundations

and government entities) will only give grants to charitable organizations, i.e., those that are tax exempt under section 501(c)(3). Obviously, well-run organizations should be meeting their reporting obligations.

So revocation is very serious—and if an organization wants to regain tax-exempt status, there are forms to fill out, fees to pay, and usually some time to wait before it is granted again.

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What Happens if I Give to a Charity That Has Lost Its Exemption?

As long as the charity has not received a revocation letter from the IRS, your contribution will still be deductible. Once the charity receives the letter, however, donations to it will no longer be deductible.

The IRS is waiting until 2011 to start sending revocation letters. At that time, it will also post a Web page of nonprofits that have lost tax-exempt status because they failed to file with the IRS for three consecutive years.

What Impact Will the Revocations Have on Grantmakers?

Private foundations and sponsors of donor-advised funds face much the same situation as donors. Grants and disbursements made to a charity that has lost exempt status but has not received a revocation letter will still be qualifying distributions, i.e., charitable gifts that reduce the amount of federal tax a grantmaker pays. Payouts made to a charity that has received a revocation letter will no longer fall into this category, and a grantmaker that declares them as qualifying distributions could be subject to excise taxes.

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Foundations may be permitted to make gifts to organizations that are not public charities under certain conditions. The foundation’s governing documents must permit this activity, and the foundation must assume expenditure responsibility for these grants. Foundations electing to assume expenditure responsibility for a grant must satisfy a complicated set of rules and reporting obligations. Failure to meet these rules could also subject the foundation to excise taxes.

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GuideStar recommends that before making a payout, grantmakers confirm that grantees have not lost tax-exempt status, in addition to verifying charitable status in IRS Publication 78 and consulting the IRS Business Master File (or a third-party provider of BMF data that meets the criteria outlined in IRS Revenue Procedure 2009-32⁴) to identify supporting organizations. Although IRS revocations will affect small nonprofit organizations disproportionately, the data confirm that tens of thousands of larger and seemingly more established nonprofits will also be removed from the IRS BMF.

IRS Response to the First Round of Revocations

When the May 17 filing deadline passed and the number of Forms 990-N received was drastically short of expectations, IRS Commissioner Doug Shulman made the following statement:

Now that the May 17 filing deadline has passed, it appears that many small tax-exempt organizations have not filed the required information return in time. These organizations are vital to communities across the United States, and I understand their concerns about possibly losing their tax-exempt status.

The IRS has conducted an unprecedented outreach effort in the tax-exempt sector on the 2006 law’s new filing requirements, but many

of these smaller organizations are just now learning of the May 17 deadline. I want to reassure these small organizations that the IRS will do what it can to help them avoid losing their tax-exempt status.

The IRS will be providing additional guidance in the near future on how it will help these organizations maintain their important tax-exempt status—even if they missed the May 17 deadline. The guidance will offer relief to these small organizations and provide them with the opportunity to keep their critical tax-exempt status intact.

So I urge these organizations to go ahead and file—even though the May 17 deadline has passed.⁵

The IRS issued the guidance on July 26, 2010, noting, “This one-time relief benefits Form 990-N (*e-Postcard*) and Form 990-EZ filers only. Organizations required to file Form 990 or Form 990-PF are not eligible and are automatically revoked if they fail to file for three consecutive years.” The guidance also specifies that this one-time relief is available to organizations whose returns were due on or after May 17 and before October 15, 2010, and reiterates that nonprofits that do lose tax-exempt status must re-apply if they want their exemptions restored.⁶ See the appendix for more information.

What Nonprofits Need to Do

If your organization has been given tax-exempt status by the IRS (that is, it has received an IRS letter of determination), consult the IRS list of filing exceptions to determine whether you need to file an annual return. If you do, assess which IRS form you should file by checking out the

requirements on the IRS Web site.⁷ Then file what is required when it is due. Be aware that extensions are available for Forms 990, 990-EZ, and 990-PF but, with the exception of the one-time relief announced in July, not for Form 990-N.

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What Donors and Grantmakers Need to Do

Stay abreast of the situation. The IRS is posting updates in the Charities & Non-Profits section of its Web site.⁸ GuideStar has created a nonprofit resource center that provides an overview of the issue and links to several resources, including a Form 990-N filing status database; information on filing exceptions, filing thresholds, and filing deadlines and extensions; and FAQs.⁹ Independent Sector is monitoring developments on the IRS Oversight page of its site.¹⁰

Once the IRS makes the revocations public, private foundations and sponsors of donor-advised funds will need to add verification of continued tax-exempt status to their pre-grant due-diligence practices. GuideStar Charity Check, GuideStar’s due-diligence tool for grantmakers, will incorporate revocation information, providing a potential grantee’s IRS Publication 78 record, BMF data, and exemption information in a single report.

The Revocation Process

The IRS has yet to detail the ongoing revocation process, other than to say that it will publish the initial list of organizations that have lost exemptions for failure to file on its Web site in 2011.

The impact of revocation is dramatic—donors can't deduct their contributions, grantmakers and funders won't commit funds, and the nonprofit will have to pay federal income tax. If it is a charitable organization, donors must be told that contributions are no longer deductible. If the organization wants to regain tax-exempt status, it must reapply for exemption and pay fees based on revenue level.¹¹ If professional assistance in filling out the form is needed, then fees for those services must also be added. Private foundations and sponsors of donor-advised funds will need to take an extra step in this time of uncertainty and change to avoid excise taxes.

Conclusion

The revocation of tax-exempt status by the IRS as required under the PPA will have a tremendous impact on the nonprofit sector. GuideStar's

analysis of the July 2010 BMF indicates that as many as hundreds of thousands of organizations may be at risk.

The long-term benefits of the revocation process are much clearer than the short-term impact. The increased transparency will lead to a more accurate picture of the nonprofit sector, as almost all active organizations will be reporting. The IRS will be able to allocate its education and enforcement resources more efficiently. Donors, funders, members, clients, and other sector stakeholders will have confidence that the organizations that receive their support have reported as required and deserve their trust.

This is a time of transition for nonprofit reporting. It may be difficult for the many small organizations with volunteer officers, but the IRS has made many resources available on its Web site, www.irs.gov, to help. In 2011, there will be more information on whether this change represents primarily a cleanup of the IRS files or whether revocations have affected many functioning organizations. But more transparency and accountability can only help increase the trust necessary to improve the nonprofit sector.

Who Files the e-Postcard and When

Exempt organizations that do not fall under a filing exception and whose annual gross receipts are normally \$25,000 or less are required to submit Form 990-N.¹² They can also choose to complete a Form 990 or Form 990-EZ, but the Form 990-N is much simpler and quicker to fill out. Although nonprofits with less than \$5,000 in annual gross receipts are not required to apply to the IRS for tax-exempt status, typically they must now file a 990-N.

The e-Postcard is due every year by the 15th day of the 5th month after the close of the organization's tax year. For example, if the tax year ends on December 31, the e-Postcard is due May 15 of the following year. This means that if an organization with gross receipts of \$20,000, for example, has a tax year that coincides with the calendar year (ends December 31), it should have filed a Form 990-N by May 15, 2008, for its 2007 activities, by May 15, 2009, for its 2008 activities, and by May 15, 2010, for its 2009 activities. And if no form was filed for each of the three years by May 15, 2010 (actually Monday, May 17, 2010, because May 15 fell on a Saturday), then the IRS is required to revoke the nonprofit's tax-exempt status.

According to the NCCS, almost 100,000 nonprofits submitted their e-Postcards to the IRS before the May 17 deadline. Since then, another 45,000 have filed, with an average of 1,000 filing every day through June 15. Although more than two-thirds of small nonprofits operate on the calendar year and had a deadline of May 17, 2010, IRS data show that there are 67,000 nonprofits that must file the e-Postcard by deadlines between July 15 and December 15 and another 25,500 that must file by April 15, 2011.

There is no late fee if the e-Postcard is not filed on time, but a failure to file an e-Postcard, Form 990, or 990-EZ for three consecutive years normally will lead to revocation of tax-exempt status.

How to File Form 990-N

Filing is online only and accessible at <http://epostcard.form990.org>. There is no charge.

The form is short and only requires eight pieces of information:

- legal name of the organization,
- any name under which the organization operates or does business,
- mailing address and Internet Web site address (if any),
- taxpayer identification number,
- name and address of a principal officer,
- evidence of the organization's continuing basis for its exemption from the generally applicable information return filing requirements (typically certifying that annual gross receipts are less than \$25,000), and
- notice of termination, if the organization no longer exists or is going out of existence.

If a 990-N filer's EIN (Employer Identification Number) is not in the IRS system, a call to IRS Customer Account Services at 877-829-5500 will be necessary.

Advice for Smaller Nonprofits That Missed a 2010 Filing Deadline

Start by checking the IRS list of organizations at risk of revocation, available at <http://www.irs.gov/charities/article/0,,id=225889,00.html>. If you find your organization on the list and its gross receipts are less than \$25,000, an officer

Appendix. Form 990-N and Filing Relief for Small Organizations

from the organization should file Form 990-N at <http://epostcard.form990.org>.

If your organization's revenues are \$25,000 or greater, view the information on <http://www.irs.gov/charities/article/0,,id=184445,00.html> to determine whether your organization qualifies to file a Form 990-EZ. If it does, follow the instructions on <http://www.irs.gov/charities/article/0,,id=225704,00.html> to participate in the Filing Relief Voluntary Compliance Program.

You will be required to pay a fee of \$100, \$200, or \$500, depending on the amount of your 2009 gross annual revenues.

If your organization is required to file Form 990 or Form 990-PF and has missed the deadline for filing your 2009 return, you cannot participate in the Filing Relief Voluntary Compliance Program. You must re-apply to the IRS if you wish to regain your exemption.

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1. For more background and detailed descriptions, see Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006, <http://www.jct.gov/x-38-06.pdf>.
2. Exceptions for certain types of organizations are still in force (churches, their integrated auxiliaries, and conventions or associations of churches; the exclusively religious activities of any religious order; section 501(c)(1) instrumentalities of the United States; section 501(c)(21) trusts; an interchurch organization of local units of a church; certain mission societies; certain church-affiliated elementary and high schools; certain state institutions whose income is excluded from gross income under section 115; certain governmental units and affiliates of governmental units; and other organizations that the IRS has relieved from the filing requirement pursuant to its statutory discretionary authority). For a list of filing exceptions, see <http://www.irs.gov/charities/article/0,,id=152729,00.html>.
3. "Here Today, Gone Tomorrow: A Look at Organizations That May Have Their Tax-Exempt Status Revoked," <http://www.urban.org/UploadedPDF/412135-tax-exempt-status.pdf>.
4. See IRS Revenue Procedure 2009-32, Reliance Criteria for Private Foundations and Sponsoring Organizations, http://www.irs.gov/pub/irs-tege/rp2009_32.pdf.
5. Statement of IRS Commissioner Doug Shulman on the Filing Deadline for Small Charities, <http://www.irs.gov/newsroom/article/0,,id=223609,00.html>.
6. <http://www.irs.gov/charities/article/0,,id=225705,00.html>.
7. See Annual Exempt Organization Returns, <http://www.irs.gov/charities/article/0,,id=152728,00.html>, for the requirements, forms, and instructions.
8. See Tax Information for Charities & Other Non-profits, <http://www.irs.gov/charities/index.html>.
9. Nonprofit Resource Center: Automatic Revocation of Tax-Exempt Status, <http://www2.guidestar.org/rxg/update-nonprofit-report/nonprofit-resource-center-automatic-revocation-of-tax-exempt-status.aspx>.
10. IRS Oversight of Charities and Foundations, http://www.independentsector.org/irs_oversight.
11. See IRS Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code, <http://www.irs.gov/pub/irs-pdf/f1023.pdf>; IRS Form 1024, Application for Recognition of Exemption under Section 501(a), <http://www.irs.gov/pub/irs-pdf/f1024.pdf>; and User Fee Program for Tax Exempt and Government Entities Division, <http://www.irs.gov/charities/article/0,,id=121515,00.html>.
12. The IRS defines gross receipts as the total amount the organization received from all sources during its annual accounting period, without subtracting any costs or expenses. See Gross Receipts Defined, <http://www.irs.gov/charities/article/0,,id=177784,00.html>. See also Gross Receipts Normally \$25,000 or Less, <http://www.irs.gov/charities/article/0,,id=177338,00.html>.