Exempt Organizations Determinations Unit 1a

Instructor Guide

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Department of the Treasury Internal Revenue Service

Training 27057-001 (Rev 6-2012)
Catalog Number
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The IRS Mission
Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

The Tax Exempt and Government Entities Mission
Provide customers top quality service by helping them understand and comply with the applicable tax laws and to protect the public interest by applying the tax law with integrity and fairness to all.
The taxpayer names and addresses shown in this publication are hypothetical. They were chosen at random from a list of American colleges and universities as shown in *Webster’s Dictionary* or from a list of counties in the United States as listed in the *United States Government Printing Office Style Manual*.

Forms shown in this publication are intended as training documents and may not reflect the most current issuance. Please check with your local office to make sure you have the most applicable form.
ERRATA SHEET

Instructions:

• Duplicate this form locally as needed to report any errors or problems with course materials.

• E-mail completed forms to:

or mail to:

Program Manager
Internal Revenue Service
TE/GE Learning & Education
500 Main St., Room 7001
Cincinnati, OH  45202

Course #27057-002: Exempt Organizations Determinations Unit 1a (Rev 6-2012)

Lesson # _____
Page # _____
Block label: ___________________________________________
Type of Error or problem:

_____ technical
_____ typographical
_____ content clarity
_____ other

Describe error or problem with the material:

Suggested solution:
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Chapter 1
Introduction to Exempt Organizations

Instructor Preparation

Estimated Time 1 hour

Reference Materials

- Instructor Guide, Chapter 1, *Introduction to Exempt Organizations*
- Student Guide, Chapter 1, *Introduction to Exempt Organizations*
- Exhibit 1-1, *IRS and TE/GE Organization Charts*
- Exhibit 1-2, *Application Processing Flow Chart*
- Exhibit 1-3, *Organization Reference Chart*

Training Aids TA 1-1, *Objectives*

Notes to Instructor Create a flip chart of the *Objectives* to display throughout the chapter, or create a transparency using TA 1-1.
Chapter 1
Objectives

After completing this chapter you will be able to:

• Identify the IRS Mission and Balanced Measures

• Describe how TE/GE fits into the IRS structure

• Identify the types of tax exempt organizations and general nature of activities
• Describe how an application is processed

• Describe the steps in making a determination

• Describe the computer applications used by EO Determinations
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Chapter 1
Introduction to Exempt Organizations

Overview

Introduction Welcome to Exempt Organizations Determinations. This chapter briefly describes what you will do as an Exempt Organizations (EO) Determinations Specialist and how you relate to the IRS and the Tax Exempt/Government Entities (TE/GE) division.

It also provides an overview of the training you will receive as a determinations specialist.

Instructor Notes Display and discuss the Objectives, or a review, on a flip chart.

Objectives After completing this chapter you will be able to:

- Identify the IRS Mission and Balanced Measures
- Describe how TE/GE fits into the IRS structure
- Identify the types of tax exempt organizations and general nature of activities
- Describe how an application is processed
- Describe the steps in making a determination
- Describe the computer applications used by EO Determinations

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<td>Exhibit 1-3: Organization Reference Chart</td>
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Introduction to the IRS, TE/GE, and Exempt Organizations

Mission Statement

The IRS Mission Statement is:

Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

TE/GE has a supporting Mission Statement:

Provide customers top quality service by helping them understand and comply with the applicable tax laws and to protect the public interest by applying the tax law with integrity and fairness to all.

Balanced Measures

With the passage of the Reform and Restructuring Act of 1998, Congress imposed what is referred to as Balanced Measures on the IRS. These measures ensure that the Service operates in a manner that respects both the customer and the employee to achieve optimal business results.

The Balanced Measures are:

- Customer Satisfaction
- Employee Satisfaction
- Business Results

Continued on next page
Introduction to the IRS, TE/GE, and Exempt Organizations,
Continued

Instructor Notes

Discuss Exhibit 1-1, *IRS and TE/GE Organization Charts*

Organizational Structure of TE/GE

TE/GE is one of the four operating divisions of the Internal Revenue Service. This division encompasses Exempt Organizations (EO), Employee Plans (EP) and Government Entities (GE), which includes Federal, State, and Local Governments (FSLG), Tax Exempt Bonds (TEB), and Indian Tribal Governments (ITG).

Exempt Organizations (EO) offers specialized assistance to charitable, religious, and educational organizations, civic associations, business leagues, social clubs, fraternal organizations and various other organizations exempt from federal income tax. EO's programs and services help tax exempt organizations understand and comply with tax laws and regulations governing their tax exempt status.

Exhibit 1-1 illustrates the organizational structure of the IRS along with organizational charts of TE/GE, EO and EO Rulings and Agreements.

Instructor Notes

Describe how EO R&A (and especially Determinations) fits into the organizational structure of IRS.

EO Functions

Both the EO and EP business units within TE/GE are divided into two distinct organizations, Rulings and Agreements and Examinations.

- The primary function of Rulings and Agreements is to make a determination concerning the qualification for exemption from Federal income tax of an organization initially applying for exempt status.
- The primary function of Examinations is to conduct examinations and reviews of the operations and records of an organization that is exempt, to find out if it merits continued exemption and to assess any applicable taxes.

Continued on next page
Introduction to the IRS, TE/GE, and Exempt Organizations,
Continued

<table>
<thead>
<tr>
<th>EO Functions (continued)</th>
<th>EO Rulings and Agreements encompasses several entities including:</th>
</tr>
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<tbody>
<tr>
<td>• EO Determinations, the unit to which you are assigned, is responsible for reviewing applications for exemption to determine if an organization meets the requirements to be recognized as exempt from federal income tax. Your role in EO Determinations is primarily to make a determination on an applicant’s qualification for exemption. In the determination process, determinations specialists also help identify and combat abusive schemes, terrorism and fraud.</td>
<td></td>
</tr>
<tr>
<td>• EO Determinations Quality Assurance (DQA) helps internal customers apply the tax law with integrity and fairness to all organizations seeking a determination recognizing tax-exempt status. The DQA Office identifies areas of the tax law or IRS procedures that present problems for internal or external customers and works with EO Determinations, EO Technical and other offices in solving those problems.</td>
<td></td>
</tr>
<tr>
<td>• EO Technical (Washington, DC) processes exemption applications that are referred by determinations specialists as well as technical advice and assistance requests from EO Exam and private letter rulings. This office also provides assistance to other government agencies on exempt organizations issues by responding to specific requests for information or technical assistance, participating in multi-agency task forces formed to address broad concerns, and analyzing actions of other agencies that may affect the tax treatment of exempt organizations.</td>
<td></td>
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</tbody>
</table>
### Instructor Notes

Have students identify any type of exempt organization of which they are aware.

### Types of Exempt Organizations

The Internal Revenue Code specifies certain types of organizations that qualify for exemption from Federal income tax. The most common types are charitable, religious and educational organizations, civic organizations, labor organizations, business leagues, social clubs, fraternal organizations and veterans’ organizations. These types of organizations are defined in the Internal Revenue Code – predominantly in section 501(c).

Generally, an organization must be organized on a non-profit, non-stock basis to qualify for exemption. Each applicant organization must be a legal entity (corporation, trust or unincorporated association).

(See Exhibit 1-3 for a Table of Organizations Exempt Under Section 501)

*Continued on next page*
Introduction to Tax Exempt Status, Continued

Instructor Notes
Briefly highlight the different subsections and note the different purposes of each subsection.

Common Types of Exempt Organizations
Some of the more common exempt organizations are defined in the following Code sections:

- 501(c)(3) Religious, Educational, Charitable
- 501(c)(4) Civic Leagues, Social Welfare Organizations
- 501(c)(5) Labor, Agricultural, or Horticultural
- 501(c)(6) Business Leagues, Chambers of Commerce
- 501(c)(7) Social and Recreational Clubs
- 501(c)(8) Fraternal Beneficiary Societies and Associations
- 501(c)(10) Domestic Fraternal Societies and Associations
- 501(c)(19) Veterans’ Organizations

The specific requirements and characteristics of each will be addressed in the remainder of your Unit 1 training.

Continued on next page
# Introduction to Tax Exempt Status, Continued

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<tbody>
<tr>
<td>Highlight the major benefits. Advise students that concepts will be explained more fully throughout the course. Briefly explain that exempt organizations are not exempt from employment taxes, certain excise taxes, and any income derived from activities unrelated to exempt function.</td>
</tr>
</tbody>
</table>

## Benefits of Exempt Status

Why does an organization or entity seek exempt status? As mentioned, the main benefit of exempt status is exemption from paying Federal income tax on any income related to the organization’s qualifying or exempt purpose.

There is a special advantage for organizations qualifying under IRC section 501(c)(3). Contributions/donations made to organizations exempt under IRC section 501(c)(3) generally are deductible as charitable contributions on the donor’s Federal income tax return. Contributions to most other organizations are not tax deductible. Other advantages to organization’s exempt under IRC section 501(c)(3) include collateral tax exemption or partial exemption from state income tax and/or local property taxes, exemption from FUTA tax and certain excise taxes and preferred postal rates.

## Some Restrictions on Exempt Organizations

There are certain restrictions placed on some categories of exempt organizations.

Most categories of exempt organizations may not be used for the “private benefit” of any individual. The intent is to ensure that a tax exempt organization serves a public rather than a private interest. Private benefit must be substantial in order to jeopardize qualification for exempt status.

“Inurement” is the term for private benefit to insiders of an organization. For most categories, the prohibition of inurement to insiders is absolute; therefore, any amount of inurement is grounds for denial of exemption.

Certain categories of exempt organizations may not engage any political activities nor conduct substantial lobbying activities.

*Continued on next page*
### Instructor Notes

Distribute blank Forms 1023 and 1024.

### Obtaining Exempt Status

Organizations apply for exemption either by application or letter. Organizations applying for exemption under section 501(c)(3) of the Code submit Form 1023. Most others apply on Form 1024. Farmers’ cooperatives apply for exemption on Form 1028 and other types of requests for exemption are made by letter.
# Introduction to the Application Process

## Determination Process

The determination process starts when an entity submits an application or request for tax exempt status to the IRS. A ruling or determination must be made on the request. The vast majority of these decisions or determinations are made by determinations specialists.

## Instructor Notes

Exhibit 1-2, *Application Processing Flow Chart*. Briefly explain the terms “technical screener”, “merit closure”, “accelerated processing”, “failure to establish”, “EO Technical”, “special handling”, etc. Many of these terms are covered in more detail in later chapters.

## Application Processing

All applications or requests for exemption are submitted to the Cincinnati Submission Processing Center (CSPC), located in Covington, Kentucky. The required fee (user fee) submitted by the applicant is processed and the application is added to TEDS and EDS (systems that are discussed later in this chapter and throughout this course). The case is then sent to the Cincinnati office for processing. Exhibit 1-2 illustrates a case’s movement through the application process.

## EP/EO Determination Processing

EP/EO Determination Processing is branch of EO Determinations and is comprised of three units:

- Records Unit
- Correspondence Unit
- Adjustments Unit

These units perform many of the administrative functions of case processing and are an integral part of the application process.

Continued on next page
Applications for exemption (or requests) are referred to as “cases” and are assigned to determinations specialists for review after case establishment. All cases assigned to a specialist at a given time are referred to as the specialist’s “case inventory.”

Generally, the following steps are used in making a determination:

1. Review the application and all supporting documentation
2. Communicate by letter or telephone for clarification of submitted information or to secure additional information as necessary
3. Determine whether the applicant meets requirements of the particular Code section based on research conducted
4. Close the case and issue a favorable determination letter, a failure to establish letter, or a proposed denial of exemption letter
Overview of EO Determinations Specialist Training

Training Curriculum

EO Determinations specialist training is provided in three separate units.

Unit 1 includes classroom training and a period of on-the-job training (OJT). Unit 1 is divided into two classroom modules:

1. Unit 1a consists provides an overview of the determination process as well as in depth training IRC section 501(c)(3) organizations
2. Unit 1b provides training on organizations exempt under other 501(c) sections of the Code

The OJT portion of training will include:

- Workshops
- Hands-on training
- Possibly some virtual classroom or electronically delivered training (e.g., Centra and/or Skillsoft sessions)
- Opportunities for feedback

This training is provided to all employees selected as new hires into the determinations specialist position.

Unit 2 is provided to specialists who are competitively promoted to Grade 12 and is classroom based.

Continued on next page
Overview of EO Determinations Specialist Training, Continued

Instructor Notes

| Stress that specialists who are competitively promoted to Grade 12 receive Unit 2. |

Unit 1a Content

You are now in Unit 1a, which is three weeks in length. You will have a period of on-the-training (OJT) followed by Unit 1b classroom instruction and additional OJT time.

Unit 1a is designed to give determinations specialists the tools needed to make appropriate determinations on applications requesting exemption under IRC section 501(c)(3) including basis in tax law, IRC section 501(c)(3) requirements and case processing. Specific topics include:

- Introduction to Tax Law
- 501(c)(3) Organizational and Operational Tests
- Case Development and Documentation
- Charitable, Religious, and Educational Organizations
- Foundation Classifications
- Case Processing, Closing, and Review

At the end of this training, you will be able to complete the steps used in the determination process.
Computer Programs, Systems, and Applications

Automated Systems and Applications

As a determinations specialist, you will be using the following computer applications on a regular basis:

- Microsoft Office (Outlook, Word, Excel)
- EP/EO Determination Systems (EDS)
- Tax Exempt Determination System (TEDS)
- Time Reporting System (WebETS)
- Intranet/Internet

Instructor Notes

Have students use computer to access Word, Outlook, and Excel.

Microsoft Office

Microsoft Office products may be used to:

- Access e-mail and public folders
- Prepare written EO reports or communications
- Prepare additional information requests to customers
- Prepare work papers and spreadsheets
- Prepare timesheet attachments
- Prepare time and attendance forms

Continued on next page
EDS is a menu-driven TE/GE automated system that is an automation of certain segments of the TE/GE determination process. Information input into EDS rolls to the Integrated Data Retrieval System (IDRS).

EDS includes the following subsystems:

- **Inventory Control Subsystem (ICS)**
  ICS tracks applications from clerical screening through closing (when application is assigned, to whom it is assigned, when it is closed, etc.)

- **Letter Generation Subsystem (LGS)**
  LGS generates letters approved for nationwide use, mostly those used to close cases.

- **Management Information Subsystem (MIS)**
  MIS generates inventory and employee roster reports. Inventory reports include all assigned cases by group, agent, status, age, etc. and unassigned cases.

Determinations specialists primarily use the ICS function of EDS. EDS is currently the system of record for all determination cases but will eventually be phased out and replaced by TEDS.
Instructor Notes

Explain gradual implementation of TEDS. Provide timeframe for training, if known.

TEDS

Tax Exempt Determinations System (TEDS) is a new, Windows based, electronic case and inventory management system for EO and EP Determinations units. TEDS is accessed via the IRS intranet.

TEDS currently interfaces with EDS to process cases but will eventually become the system of record for all determination cases allowing for paperless case processing. TEDS will eliminate dependency on multiple systems and provide real-time access to inventory data.

TEDS training will be provided prior to system use.

Instructor Notes

Begin entering time on 6490 – up-to-date – Formal Training. Stress the importance of keeping up with the timesheet daily or at least weekly. Distribute Document 6379 and explain how this book is used, e.g. ETS, EDS, etc.

WebETS

WebETS is the TE/GE Employee Time System and is accessible via the IRS Intranet. The information in this system is used by:

- EO technical personnel to capture actual time expenditure and
- Management to monitor plan vs. actual time expenditure

All operational and non-operational time is reported electronically in hours by code designations on Form 6490 TE/GE Technical Time Report.
Instructor Notes

Have students access the Intranet and the Internet.

Intranet/Internet

The Intranet is the internal IRS network and is used to access internal information such as forms, publications, personnel information, internal procedures, and various employee services.

The Internet is used to conduct research into applicants.

IDRS

All current tax data is stored in IDRS. IDRS is the system that contains the Exempt Organizations Master File (EOMF).

Information that can be retrieved from IDRS includes, but is not limited to organization name and address, subsection, foundation classification, status and filing requirements.

Information secured from IDRS is often referred to as internal “research.” Determinations specialists generally do not have access to IDRS and may request any needed research from the group secretary or other designated individual.

Explain the purpose of IDRS and the EO Master File. Additional information is provided in Chapter 16.
Summary

TE/GE is one of the four operating divisions of the Internal Revenue Service. This division encompasses Exempt Organizations (EO), Employee Plans (EP) and Government Entities (GE), which includes Federal, State, and Local Governments (FSLG), Tax Exempt Bonds (TEB), and Indian Tribal Governments (ITG).

Both the EO and EP business units within TE/GE are divided into two distinct organizations, Rulings and Agreements and Examinations. The Internal Revenue Code specifies certain types of organizations that qualify for exemption from Federal income tax. The most common types are charitable, religious and educational organizations, civic organizations, labor organizations, business leagues, social clubs, fraternal organizations and veterans’ organizations. These types of organizations are defined in the Internal Revenue Code – predominantly in section 501(c).

The determination process starts when an entity submits an application or request for tax exempt status to the IRS. A ruling or determination must be made on the request. The vast majority of these decisions or determinations are made by determinations specialists.

EO Determinations specialist training is provided in three separate units which includes Unit 1a, Unit 1b and On-the-Job (OJI) training.

As a determinations specialist, you will be using the following computer applications on a regular basis:

- Microsoft Office (Outlook, Word, Excel)
- EP/EO Determination Systems (EDS)
- Tax Exempt Determination System (TEDS)
- Time Reporting System (WebETS)
- Intranet/Internet

Instructor Notes

Administer and go over answers to Class Exercise 1-1.
TE/GE EO Rulings and Agreements

Director
EO Rulings and Agreements

Determinations QA

EO Determinations

EP/EO Determinations Processing

EO Technical Groups

EO Technical

Technical Guidance and QA

Adjustments

Correspondence

Records
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<th>Section of 1986 Code</th>
<th>Description of organization</th>
<th>General nature of activities</th>
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<td>Corporations Organized Under Act of Congress (including Federal Credit Unions)</td>
<td>Instrumentalities of the United States</td>
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<td>501(c)(2)</td>
<td>Title Holding Corporation for Exempt Organization</td>
<td>Holding title to property of an exempt organization</td>
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<td>501(c)(3)</td>
<td>Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations</td>
<td>Activities of a nature implied by the description of the class of organization</td>
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<td>501(c)(4)</td>
<td>Civic Leagues, Social Welfare Organizations, and Local Associations of Employees</td>
<td>Promotion of community welfare; charitable, educational or recreational</td>
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<td>501(c)(5)</td>
<td>Labor, Agricultural, and Horticultural Organizations</td>
<td>Educational or instructive, the purpose being to improve conditions of work, and to improve products</td>
</tr>
<tr>
<td>501(c)(6)</td>
<td>Business Leagues, Chambers of Commerce, Real Estate Boards, Etc.</td>
<td>Improvement of business conditions of one or more lines of business</td>
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<td>501(c)(7)</td>
<td>Social and Recreation Clubs</td>
<td>Pleasure, recreation, social activities</td>
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<td>501(c)(8)</td>
<td>Fraternal Beneficiary Societies and Associations</td>
<td>Lodge providing for payment of life, sickness, accident, or other benefits to members</td>
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<td>501(c)(9)</td>
<td>Voluntary Employees’ Beneficiary Associations</td>
<td>Providing for payment of life, sickness, accident, or other benefits to members</td>
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<td>501(c)(10)</td>
<td>Domestic Fraternal Societies and Associations</td>
<td>Lodge devoting its net earnings to charitable, fraternal, and other specified purposes. No life, sickness, or accident benefits to members</td>
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<td>501(c)(11)</td>
<td>Teachers’ Retirement Fund Associations</td>
<td>Teachers’ association for payment of retirement benefits</td>
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<td>501(c)(12)</td>
<td>Benevolent Life Insurance Associations, Mutual Ditch or Irrigation Companies, Mutual or Cooperative Telephone Companies, Etc.</td>
<td>Activities of a mutually beneficial nature similar to those implied by the description of class of organization</td>
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<td>501(c)(13)</td>
<td>Cemetery Companies</td>
<td>Burials and incidental activities</td>
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<td>501(c)(14)</td>
<td>State Chartered Credit Unions, Mutual Reserve Funds</td>
<td>Loans to members</td>
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<tr>
<td>Section of 1986 Code</td>
<td>Description of organization</td>
<td>General nature of activities</td>
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<td>501(c)(15)</td>
<td>Mutual Insurance Companies or Associations</td>
<td>Providing insurance to members substantially at cost</td>
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<td>501(c)(16)</td>
<td>Cooperative Organizations to Finance Crop Operations</td>
<td>Financing crop operations in conjunction with activities of a marketing or purchasing association</td>
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<td>501(c)(17)</td>
<td>Supplemental Unemployment Benefit Trusts</td>
<td>Provides for payment of supplemental unemployment compensation benefits</td>
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<td>501(c)(18)</td>
<td>Employee Funded Pension Trust (created before June 25, 1959)</td>
<td>Payment of benefits under a pension plan funded by employees</td>
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<td>501(c)(19)</td>
<td>Post or Organization of Past or Present Members of the Armed Forces</td>
<td>Activities implied by nature of organization</td>
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<td>501(c)(21)</td>
<td>Black Lung Benefit Trusts</td>
<td>Funded by coal mine operators to satisfy their liability for disability or death due to black lung diseases</td>
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<td>501(c)(22)</td>
<td>Withdrawal Liability Payment Fund</td>
<td>To provide funds to meet the liability of employers withdrawing from a multi-employer pension fund</td>
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<td>501(c)(23)</td>
<td>Veterans Organization (created before 1880)</td>
<td>To provide insurance and other benefits to veterans</td>
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<td>501(c)(25)</td>
<td>Title Holding Corporations or Trusts with Multiple Parents</td>
<td>Holding title and paying over income from property to 35 or fewer parents or beneficiaries</td>
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<td>501(c)(26)</td>
<td>State-Sponsored Organization Providing Health Coverage for High-Risk Individuals</td>
<td>Provides health care coverage to high-risk individuals</td>
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<tr>
<td>501(c)(27)</td>
<td>State-Sponsored Workers’ Compensation Reinsurance Organization</td>
<td>Reimburses members for losses under workers’ compensation acts</td>
</tr>
<tr>
<td>501(d)</td>
<td>Religious and Apostolic Associations</td>
<td>Regular business activities. Communal religious community</td>
</tr>
<tr>
<td>501(e)</td>
<td>Cooperative Hospital Service Organizations</td>
<td>Performs cooperative services for hospitals</td>
</tr>
<tr>
<td>501(f)</td>
<td>Cooperative Service Organizations of Operating Educational Organizations</td>
<td>Performs collective investment services for educational organizations</td>
</tr>
<tr>
<td>Section of 1986 Code</td>
<td>Description of Organization</td>
<td>General nature of activities</td>
</tr>
<tr>
<td>----------------------</td>
<td>--------------------------------------</td>
<td>------------------------------------------------------------------</td>
</tr>
<tr>
<td>501(k)</td>
<td>Child Care Organization</td>
<td>Provides care for children</td>
</tr>
<tr>
<td>501(n)</td>
<td>Charitable Risk Pools</td>
<td>Pools certain insurance risks of 501(c)(3) organizations</td>
</tr>
<tr>
<td>521(a)</td>
<td>Farmers’ Cooperative Associations</td>
<td>Cooperative marketing and purchasing for agricultural producers</td>
</tr>
</tbody>
</table>
This page intentionally left blank.
1. A ________________ is made when the IRS makes a decision concerning the qualification for exemption of an organization initially applying for exempt status.

2. Exempt Organizations Determinations is part of Services and Enforcement.
   (a) True  (b) False

3. Contributions made to all exempt organizations are tax deductible by the donor.
   (a) True  (b) False

4. ______________ is a menu driven system that is an automation of certain segments of the EP/EO determination system.

5. ______________ is the information system used by EO technical personnel to capture actual time expenditure on Form 6490 often referred to as the “timesheet”.

6. Which of the following is not one of the balance measures?
   (a) Business Results  (b) Customer Satisfaction
   (c) Enforcement  (d) Employee Satisfaction

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Answers:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Determination.</td>
<td>2. True: Determinations is part of Rulings and Agreements which is part of Exempt Organizations which is part of TEGE which is part of Services and Enforcement. 2. False 3. False Contributions are generally only deductible to organizations described in section 501(c)(3).??? 4. EDS This program includes subsystems CSS (Clerical Screening Subsystem), ICS (Inventory Control Subsystem), and LGS (Letter Generation Subsystem).?? 5. ETS This program records actual time expended daily by a determination specialist and also provides management a method to monitor plan vs. actual time expended. 6. C The balanced measures are Employee Satisfaction, Customer Satisfaction, and Business Results.</td>
</tr>
</tbody>
</table>
## Chapter 2
### Introduction to EO Tax Law

**Instructor Preparation**

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>2 hours</th>
</tr>
</thead>
</table>
- Student Guide, Chapter 2, *Introduction to EO Tax Law* |
| Training Aids | TA 2-1, *Objectives* |
| Notes to Instructor | Create a flip chart of the *Objectives* to display throughout the chapter, or create a transparency using TA 2-1. |
Chapter 2
Objectives

After completing this chapter you will be able to:

• Describe how tax law applies to EO Determinations

• Identify the three basic types of authoritative documents

• Name available Service publications and resources
Chapter 2
Introduction to EO Tax Law

Overview

Introduction

In order to recommend exemption, a specialist’s justification for a determination must be based on tax law. Tax law may be very specific to a particular type of organization or applicable to more than one type of organization. Application of tax law begins when a case is initially reviewed and is applied throughout processing. When closing a case that was sent to the group for development, the specialist explains the tax law applied.

The various sources of EO tax law and how they are used are discussed in this chapter.

Instructor Notes

Display and discuss the Objectives, or a review, on the flip chart.

Objectives

After completing this chapter you will be able to:

- Describe how tax law applies to EO Determinations
- Identify the three basic types of authoritative documents
- Recognize available Service publications and resources

Continued on next page
Overview, Continued

This chapter contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
<td>1</td>
</tr>
<tr>
<td>Tax Law Research and Authority</td>
<td>3</td>
</tr>
<tr>
<td>Statutory Authority</td>
<td>5</td>
</tr>
<tr>
<td>Administrative Authority</td>
<td>7</td>
</tr>
<tr>
<td>Judicial Authority</td>
<td>14</td>
</tr>
<tr>
<td>Service Publications</td>
<td>20</td>
</tr>
<tr>
<td>Other Service Resources</td>
<td>22</td>
</tr>
<tr>
<td>Summary</td>
<td>24</td>
</tr>
<tr>
<td>Exercise 2-1</td>
<td>25</td>
</tr>
<tr>
<td>Exercise 2-2</td>
<td>26</td>
</tr>
<tr>
<td>Exercise 2-3</td>
<td>27</td>
</tr>
</tbody>
</table>
Tax Law Research and Authority

**Instructor Notes**
Write “Statutory”, “Administrative”, and “Judicial” on the whiteboard.

**Research**
Determinations specialists base determinations on established precedent. In addition to accounting principles, the specialist must interpret the law to determine whether applicants qualify for exemption. In determining which precedent to apply, the specialist will:

- Analyze the available facts submitted with the application for exemption
- Pinpoint the legal issues involved
- Formulate an appropriate tax question(s) to be researched
- Apply the tax law to the facts of the case

Once the tax question to be researched has been formulated, the search for relevant authority can begin. Preliminary research may indicate the need for additional facts from the organization.

Knowing the legal basis for exemption is the first step in reviewing an application for exemption. A specialist should not resolve all of the administrative issues in the application and then realize that the applicant does not even qualify for exemption.

*Continued on next page*
## Instructor Notes

Stress that in addition to accounting principles, we must interpret the law to determine whether an organization qualifies for exemption.

Knowing the legal basis of exemption is the first step in reviewing an application. We do not resolve all the administrative issues and then later realize the organization doesn’t qualify for exemption.

## Authority Types

There are three basic types of authoritative documents. In hierarchal order of importance, they are:

- Statutory
- Administrative
- Judicial
Statutory Authority

**Instructor Notes**

Distribute the Internal Revenue Code if students have not already received their copies.

The Internal Revenue Code is Title 26 of the United States Code.

Have students complete Exercise 2-1 (finding Code cites).

**Internal Revenue Code**

The Internal Revenue Code (IRC or the Code) is the statutory foundation of all Federal tax authority, except for occasional uncodified provisions and certain international issues covered in tax treaties with foreign countries. Prior to 1939, each individual revenue act passed by Congress amounted to a complete reenactment of the entire tax law. In 1939, however, all Federal tax law was consolidated into Title 26 of the *United States Code* as the *Internal Revenue Code of 1939*, and subsequent revenue acts were used to amend the 1939 Code. By 1954, the growth of Federal taxation led Congress to completely revise the 1939 Code. The Internal Revenue Code of 1954 was that revision. Despite frequent amendments, the designation “1954” remained fixed with the Code until the Tax Reform Act of 1986 replaced it with “1986.”

**Interpreting the Code**

The Internal Revenue Code (IRC) is binding on all courts except when held to violate the Constitution. The judiciary gives great importance to the literal language of the Code. This language does not resolve every tax controversy. In interpreting the Code, the courts also consider the following:

- The history of a particular Code section
- Its relationship to other Code sections
- Reports of Congressional committees
- Treasury Regulations
- IRS administrative policies

*Continued on next page*
Reading the Code can, on occasion, become difficult because of references to “subsections,” “paragraphs,” “subparagraphs,” etc. The various Code divisions of IRC section 170(b)(1)(A)(vi) are set forth below for illustrative purposes:

<table>
<thead>
<tr>
<th>Title</th>
<th>26</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subtitle</td>
<td>A</td>
</tr>
<tr>
<td>Chapter</td>
<td>1</td>
</tr>
<tr>
<td>Subchapter</td>
<td>B</td>
</tr>
<tr>
<td>Part</td>
<td>VI</td>
</tr>
<tr>
<td>Subpart</td>
<td>none</td>
</tr>
<tr>
<td>Section</td>
<td>170</td>
</tr>
<tr>
<td>Subsection</td>
<td>(b)</td>
</tr>
<tr>
<td>Paragraph</td>
<td>(1)</td>
</tr>
<tr>
<td>Subparagraph</td>
<td>(A)</td>
</tr>
<tr>
<td>Clause</td>
<td>(vi)</td>
</tr>
<tr>
<td>Inferior Clause</td>
<td>none — an inferior clause would be shown as (I), (II), etc., in italics.</td>
</tr>
</tbody>
</table>

Section numbers are of particular importance since they run consecutively throughout the entire Code, thus allowing a particular provision to be identified by section number alone.

References to the Code may be cited as “section 501(c)(*) of the Internal Revenue Code,” “IRC section 501(c)(*),” or “section 501(c)(*) of the Code.”
## Administrative Authority

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Treasury Regulations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribute the Treasury Regulations if the students have not yet received their copies. Highlight that the Regulations are designed to administer the tax laws as passed by Congress. Have students complete Exercise 2-2 (finding Regs. Cites)</td>
<td></td>
</tr>
</tbody>
</table>

IRC section 7805 gives the Secretary of the Treasury or his delegate a general power to prescribe necessary rules and regulations to administer tax laws as passed by Congress. While not having the force and effect of law, regulations are the Treasury Department’s official interpretation of how a particular section of the Code is to be applied and, in effect, constitute an administrative extension of the law-making process.

Treasury Regulations (Treas. Reg.) are accorded great weight by the courts and generally will be upheld unless they are found to be clearly contrary to Congressional intent. Normally, the longer a regulation remains on the books without successful challenge, the greater weight the courts will accord it. Likewise, the fact that the legislature ignores a regulation of long-standing may be construed as tacit approval. However, courts are not necessarily bound by these traditions or conventions. Service employees, of course, are always bound by valid regulations.

*Continued on next page*
### Administrative Authority, Continued

**Income Tax Regulations**

The Income Tax Regulations (Reg.) are the Service’s interpretation of the laws as written in the Code. The Regulations are cross referenced to the Code by section and generally give a more detailed presentation of each subject.

Final regulations are published in the *Federal Register*; temporary regulations, published as Treasury Decisions, are produced in the weekly Internal Revenue Bulletin (I.R.B.) and semi-annual Cumulative Bulletin (C.B.). All persons concerned are thus given notice of the official rules of the Treasury Department for the administration, application, and enforcement of the internal revenue laws. In some cases, the law requires that regulations be issued with respect to specific matters; in other cases, regulations are authorized by law to supply such detail concerning the administration of the provision of the law and its interpretation as is appropriate to carry out the statutory enactment.

So long as the regulations of the Commissioner, approved by the Secretary of the Treasury or his delegate, remain in effect, they must be observed by all members of the Service. However, they are not binding on the courts.

**Proposed Regulations**

Regulations are usually first issued in “proposed” form. Notice of proposed regulations appears in both the *Federal Register* and the I.R.B., after which interested parties have a period of time to react to the contents of the proposed regulations and to submit written comments and/or request a public hearing. The comments received may result in proposed regulations being withdrawn or modified. Proposed regulations are sometimes used by EO Technical for guidance in the issuance of rulings or technical advice but should not be cited as authority.

**Temporary Regulations**

After major changes to the Code, particularly where precise rules are needed urgently (for example, as to new elections by taxpayers), the Treasury Department often issues “temporary regulations” in the interest of expediency without holding public hearings. Temporary regulations have the same authority as final regulations and should not be confused with proposed regulations.

Temporary regulations are not issued in proposed form. They are issued originally as Treasury Decisions and are effective immediately as regulations.

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*Continued on next page*
Final regulations are published as Treasury Decisions (T.D.s) in the Federal Register and the I.R.B. They are then codified into Title 26 of the Code of Federal Regulations. Regulations are then numbered with a prefix or “part number” identifying the general area to which they are related.

<table>
<thead>
<tr>
<th>Prefix #</th>
<th>Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Income Tax Regulations</td>
</tr>
<tr>
<td>20.</td>
<td>Estate Tax Regulations</td>
</tr>
<tr>
<td>53.</td>
<td>Foundation and similar excise taxes</td>
</tr>
</tbody>
</table>

The first group of numbers following the decimal indicates the section of the Code that the regulation interprets. The last group represents the sequence of the regulation but does not correlate directly with the sequence designation of the Code.

Occasionally, two sets of regulations will appear governing the same Code section for different periods of time. For example, due to major revisions in the Tax Reform Act of 1969, new regulations were issued in 1972 to govern IRC section 170 dealing with charitable contributions. The new regulations were distinguished from those applicable to tax years prior to 1970 through the addition of a capital letter “A” (e.g., Reg. 1.170A-1).

In the case of regulations under IRC section 6033 relating to filing requirements before and after December 31, 1969, the designations are 301.6033-1 and 301.6033-2. To identify current and non-current regulations, especially in light of major revisions made by the Tax Reform Act of 1986, it is helpful to be made aware of this procedure.

Continued on next page
Revenue Rulings

Revenue rulings (Rev. Rul.) are issued by the Service and published weekly in the Internal Revenue Bulletin (I.R.B.). They are also published semi-annually in the Cumulative Bulletin (C.B.). They explain the Service position on specific facts and circumstances to ensure that an issue will be handled uniformly in other situations.

A determinations specialist is responsible for administering the tax law based on the Service’s interpretation. Revenue rulings do not carry the same force of authority as Treasury Regulations because each ruling is limited to the facts provided. Consequently, revenue rulings provide valid precedent only if the facts are similar to the facts presented by the organization applying for exemption. In applying revenue rulings, the effect of subsequent legislation, regulations, court decisions, and other revenue rulings should always be considered.

In situations involving similar facts, revenue rulings may be cited as authority for your determination. The courts, however, are not bound to reach the same interpretation as expressed in a revenue ruling.

Revenue Procedures

Revenue procedures (Rev. Proc.) announce administrative practices and procedures followed by the Service. They are also published weekly in the I.R.B. and semi-annually in the C.B. Those of general applicability are added to the Service’s Statement of Procedural Rules and published in Part 601 of the Code of Federal Regulations.

Revenue Procedures generally set forth guidelines to taxpayers on how to interact with the Service. For example, the proper procedures for requesting a determination letter or ruling letter would be typical subject matter.
### Administrative Authority, Continued

**Notices and Announcements**

Notices and announcements are of lesser importance and are generally used to keep the public informed about hearings on proposed regulations, the opening of determination letter programs, and so forth.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain that the IRM serves as our “Operating Procedures” to process cases.</td>
</tr>
<tr>
<td>Have students use their laptops to access the IRM electronically.</td>
</tr>
<tr>
<td>Have students complete Exercise 2-3 (finding references in the IRM).</td>
</tr>
</tbody>
</table>

**Internal Revenue Manual**

The Internal Revenue Manual (IRM) is designed to serve as the single official compilation of policies, procedures, instructions, and guidelines relating to the organization, functions, administration, and operation of the Service.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain that the IRM is changed to include new procedures, updates to tax law, etc.</td>
</tr>
</tbody>
</table>

**Changes to the IRM**

As policies and procedures are modified, the IRM is rewritten to incorporate the changes. You will need to be alert to any Manual changes as they are released by the Service to be certain you are using the most current information in the course of your position as a determinations specialist.

*Continued on next page*
The following is a list of the current chapters in Part 7 that you will be using for EO Determinations:

<table>
<thead>
<tr>
<th>IRM Applicable to EO Determinations</th>
<th>7.20</th>
<th>Exempt Organizations Determination Letter Program</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>7.21</td>
<td>Exempt Organizations Automated Processing Procedures</td>
</tr>
<tr>
<td></td>
<td>7.22</td>
<td>Exempt Organizations EDS User Manual</td>
</tr>
<tr>
<td></td>
<td>7.25</td>
<td>Exempt Organizations Determinations Manual</td>
</tr>
<tr>
<td></td>
<td>7.27</td>
<td>Exempt Organizations Tax Manual</td>
</tr>
<tr>
<td></td>
<td>7.28</td>
<td>Exempt Organizations Disclosure Procedures</td>
</tr>
</tbody>
</table>

Currently, Part 7 of the IRM is divided into Chapters, Sections, Subsections, Paragraphs and Subparagraphs.

<table>
<thead>
<tr>
<th>Example</th>
<th>IRM</th>
<th>7.25</th>
<th>EO Determinations Manual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter</td>
<td>3</td>
<td>7.25</td>
<td>Religious, Charitable, etc.</td>
</tr>
<tr>
<td>Section</td>
<td>3.2</td>
<td>7.25</td>
<td>Organizational Test</td>
</tr>
<tr>
<td>Subsection</td>
<td>3.2.1</td>
<td>7.25</td>
<td>Corporations</td>
</tr>
<tr>
<td>Paragraph</td>
<td>3.2.4(3)</td>
<td>7.25</td>
<td>Organizing Document Signatures</td>
</tr>
<tr>
<td>Subparagraph</td>
<td>3.2.4(3)b</td>
<td>7.25</td>
<td>Failure to Sign Procedures</td>
</tr>
</tbody>
</table>

Continued on next page
**Administrative Authority**

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>State how much it costs for a taxpayer to get a private letter ruling - $8,700 as of 2008.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Private Letter Rulings</th>
</tr>
</thead>
<tbody>
<tr>
<td>A private letter ruling (PLR) is a written statement issued to a taxpayer by EO Technical that interprets and applies the tax law to a specific set of facts. It was developed to provide taxpayers with a definite and reliable determination as to the tax treatment of a future transaction. Prior to the enactment of IRC section 6110, letter rulings were not released as public information. With the advent of the Freedom of Information Act (FOIA), redacted letter rulings became available to the general public. They still cannot be cited as legal authority but they do provide the current “thinking” and “intent” of EO Technical on a given issue.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Technical Advice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technical advice is written guidance furnished by EO Technical. It is a response to an Area Office request for the interpretation and application of Internal Revenue laws, related statutes, and regulations to a specific application or examination. You will find current procedures for requesting technical advice in IRM 7.1.4.</td>
</tr>
</tbody>
</table>
Judicial Authority

Introduction

When statutory or administrative authority alone fails to resolve a particular research problem, it may be necessary to consult judicial authority. To assess the relative weight of authority given to court decisions it is necessary to have a basic familiarity with the various Federal courts that hear tax cases.

Instructor Notes

Explain that in the determination process, the organization can only seek declaratory judgment under section 7428 through the Tax Court. This applies only to IRC § 501(c)(3) organizations.

United States Tax Court

The United States Tax Court consists of nineteen judges, each appointed by the President for a fifteen year term. Although the principal office of the Tax Court is located in Washington, D.C., the court conducts hearings in most large cities in the United States, usually with only a single judge present. After hearing a case, the assigned judge submits the findings of fact and an opinion, in writing, to the Chief Judge who then decides whether the case should be reviewed by the full court. If sufficient facts are stipulated, the assigned judge may render an opinion without a formal trial. Juries are not used in the Tax Court.

In most cases, the Chief Judge will decide that a full review by all nineteen judges is not necessary. In that event, the opinion will stand and be issued as either a “regular” or “memorandum” decision of the Tax Court. Memorandum opinions involve well established principles of law that, in the opinion of the Chief Judge, require only a delineation of the facts. Courts do cite “memorandum” decisions, however, and both forms of Tax Court decisions should be considered to have precedent value.

The jurisdiction of the Tax Court covers only tax deficiencies and IRC section 7428 declaratory judgment cases, not claims for a refund which must be tried in either a U.S. District Court or U.S. Claims Court. Because, unlike most Federal courts, the Tax Court hears only tax cases, Tax Court judges are believed to have substantially greater tax law expertise than judges in the other trial courts. For example, a bankruptcy court hears only bankruptcy cases.

Continued on next page
Acquiescence or Non-acquiescence

Acquiescence is the Commissioner’s method of indicating acceptance of a Tax Court decision that is adverse to the Service’s position in the case. Note that acquiescence does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Tax Court for its conclusions. Such acquiescence should be relied upon by Service personnel as conclusions of the Service only in application of the law to the facts in the particular case at issue. Caution should be exercised in extending application of the decision to similar cases, unless the facts and circumstances are substantially the same. Consideration should be given also to the effect of new legislation, regulations, and rulings, as well as to subsequent court decisions and actions relevant to the issue.

Non-acquiescence is the Commissioner’s notice that the Service does not accept an adverse decision of the Tax Court and will not follow it in other cases involving the same issue. Generally, such cases are appealed to a higher court. If a non-acquiesced case is appealed and the Court of Appeals upholds the Tax Court, the Service may conclude that there is no basis for further litigation and will announce withdrawal of the non-acquiescence and substitute acquiescence. On the other hand, the Commissioner may petition the Supreme Court for a writ of certiorari to review the case or may not follow the Appeals Court decision in other cases involving the same issue in the hope of obtaining a favorable decision in a later case. Acquiescence is sometimes withdrawn and non-acquiescence substituted.

Availability of Tax Court Decisions

Prior to 1943, the Tax Court was known as the Board of Tax Appeals and its decisions (both regular and memorandum) were reported in volumes cited as the United States Board of Tax Appeals Reports (B.T.A.). Since the latter part of 1942, regular Tax Court decisions have been published by the Government Printing Office (GPO) as the Tax Court of the United States Reports (T.C.).

The government provides only unbound copies of memorandum decisions under the title Tax Court Memorandum Decisions (T.C.M.) and Prentice Hall makes them available as the T.C. Memorandum Decisions (P-H) (T.C. Memo).
Judicial Authority, Continued

**Availability of Tax Court Decisions** (continued)

Citations containing the letters “USTC” do not refer to Tax Court cases. *United States Tax Cases* (U.S.T.C.) is a special reporter service published by Commerce Clearing House (CCH) containing all of the tax cases decided by all Federal courts other than the Tax Court. Both CCH and Prentice Hall publish such cases with the Prentice Hall service being called *American Federal Tax Reports* (A.F.T.R.) for years prior to 1958 and *American Federal Tax Reports, 2nd Series* (A.F.T.R. 2d) for years after 1957.

**U.S. District Court**

The Federal judicial system is divided into twelve judicial circuits. Each of the twelve circuits is further divided into districts. Each state has at least one district court in which both tax and non-tax litigation is heard. Taxpayers may sue in a Federal district court only if they first pay the tax deficiency assessed by the Service and then sue for a refund. (In addition, the District Court for the District of Columbia along with the Tax Court and the Claims Court handles IRC section 7428 declaratory judgment cases for taxpayers nationwide.) Only in a district court can a taxpayer request a jury trial in a tax dispute.

Published decisions of the U.S. district courts, including both tax and all other types of litigation, are contained in the *Federal Supplement* (F. Supp.) published by West Publishing Company. The tax decisions of the district courts are also published in U.S.T.C. and A.F.T.R. or A.F.T.R. 2d.

**U.S. Claims Court**

Prior to October 1, 1982, some tax cases were heard in a court called the U.S. Court of Claims. Decisions of the Court of Claims could be appealed only to the U.S. Supreme Court. However, under the “Federal Courts Improvement Act of 1982,” the U.S. Court of Claims was merged with the Court of Customs and Patent Appeals and is now called the U.S. Court of Appeals for the Federal Circuit. At the same time, a new trial court called the U.S. Claims Court was established. As in a district court, a taxpayer must first pay the disputed amount before bringing suit before this court except for IRC section 7428 declaratory judgment cases. The Claims Court has nationwide jurisdiction and sits in Washington, D.C.

*Continued on next page*
Decisions of the Tax Court and the district courts may be appealed either by the Service or the taxpayer to the U.S. circuit court of appeals of jurisdiction. Jurisdiction is based on the location of the taxpayer’s residence. Each circuit must follow the decisions of the Supreme Court but not those of the other circuits. However, the Eleventh Circuit has announced that it will follow the case precedent of the Fifth Circuit for those cases decided prior to its creation on October 1, 1981. The Eleventh Circuit is composed of three states (Alabama, Georgia, and Florida) previously included in the Fifth Circuit.

When conflicts develop between the circuits, district courts of each individual circuit are required to follow precedent set by the appellate court of their own circuit. Also, the Tax Court follows the policy of observing precedent set by the appellate court of the circuit in which the taxpayer resided.

All decisions of the various circuit courts are published by West Publishing Company in the *Federal Reporter – 2nd series* (F.2d). The tax decisions are also contained in U.S.T.C. and A.F.T.R. or A.F.T.R. 2d.

Final appeals from a circuit court of appeals rest with the Supreme Court. Appeal is by “Writ of Certiorari” that either may or may not be granted. Refusal to grant the writ (reported as “cert. den.”) does not mean that the Supreme Court necessarily agrees with the decision of the lower court, only that the Court did not wish to hear the case.

Most tax cases heard by the Supreme Court involve conflicts of law among the circuit courts. However, certiorari may also be granted in cases involving constitutional issues or when the government can demonstrate unusual administrative significance.

All Supreme Court decisions are published by the U.S. Government Printing Office in *U.S. Reports* (U.S.) and by West Publishing Company in the *Supreme Court Reporter* (S. Ct.). The tax decisions are published in U.S.T.C., A.F.T.R. or A.F.T.R. 2d, and the I.R.B.
Judicial Authority, Continued

When a court issues a decision adverse to the Service’s position, the Service can acquiesce or non-acquiesce to the decision. This is done as an Action on Decision which provides the following:

- Gives the name of the taxpayer and other information that identifies the case and the court in which it was tried
- Shows the years, amount, and kind of tax involved
- States the issue or issues involved
- Discusses the case and the decision
- Recommends what action should be taken

A recommendation made in any Action on Decision on a Tax Court decision, if published, appears as an announcement of acquiescence or non-acquiescence in the Internal Revenue Bulletin.

In most instances, the Service will publicly announce an “acquiescence” or “non-acquiescence” to adverse regular Tax Court decisions. This policy does not include Tax Court memorandum decisions or decisions of other courts.

Acquiescence and non-acquiescence are announced weekly in the I.R.B. If a case involves multiple issues, it is important to check the original announcement in the I.R.B. because it is possible that the Service has acquiesced with respect to only one of those issues.

However, the Commissioner is not obligated to announce either acquiescence or non-acquiescence in any Tax Court decision. Hence, for some Tax Court cases there will be no published acquiescence or non-acquiescence.

Continued on next page
As to decisions by other courts, the Service may announce whether or not it will follow them in a Technical Information Release (TIR), which may later be published as a Revenue Ruling. However, for the majority of U.S. District Court, U.S. Court of Claims, and the U.S. Court of Appeals cases there is no published announcement of the Service’s position unless the decision itself is published in the Bulletin.

After important adverse decisions, primarily those decided by the U.S. Court of Appeals, it is the policy of the Service to announce when the Service has decided to no longer litigate the issue involved as soon as possible instead of waiting until the necessary modification or revocation of outstanding rulings and regulations is made. Similar announcements are made where it is decided to put the public on notice that the Service will not follow an adverse case and will litigate it further.

Such announcements are generally made by means of Technical Information Releases and later published in the Internal Revenue Bulletin.

Acquiescence or non-acquiescence published in the I.R.B. or as Technical Information Releases represents the official position of the Service. Since these positions are published, they may be referred to not only in material for Internal Revenue Service purposes but in rulings and communications with taxpayers. Actions on Decisions give the reasoning behind the acquiescence or non-acquiescence and so provide background material not obtainable elsewhere.
Service Publications

Introduction

The following Service bulletins contain the text of almost every primary authority and provide a means to locate needed information.

- Internal Revenue Bulletin
- Cumulative Bulletin

In addition, the Service publishes informational documents/publications for use by the public.

Internal Revenue Bulletin (I.R.B.)

The weekly I.R.B. is divided into four parts.

1. Part I gives the text of all revenue rulings and final regulations issued during the week (publication is in relevant Code section order)
2. Part II contains tax treaties and tax legislation
3. Part III contains administrative and procedural items (such as revenue procedures)
4. Part IV has items of general interest

Cumulative Bulletin (C.B.)

Every six months the material in the I.R.B. is republished in a hardbound C.B. The format follows that of the I.R.B. with two exceptions:

- Major tax legislation and committee reports generally appear in a third volume rather than in the two semiannual volumes
- Only disbarment notices appear from Part IV

Continued on next page
Service Publications, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>There are many publications referenced in the chapter. The majority will not be passed out in paper form. Maybe pass out the ones which are commonly used, such as Pub. 557, 598, 3079, etc.</td>
</tr>
<tr>
<td>Remind the class that all pubs are available at <a href="http://www.irs.gov">www.irs.gov</a>, the internal Forms/Pubs/Products repository, etc.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>IRS Publications</th>
</tr>
</thead>
<tbody>
<tr>
<td>There are numerous IRS publications (Pubs) that can be helpful to both you and the general public. They can all be found on the Service website at <a href="http://www.irs.gov">www.irs.gov</a>. You will find the following publications most helpful:</td>
</tr>
<tr>
<td>- <strong>Pub. 78</strong> – Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986</td>
</tr>
<tr>
<td>- <strong>Pub. 557</strong> – Tax Exempt Status for Your Organization</td>
</tr>
<tr>
<td>- <strong>Pub. 598</strong> – Tax on Unrelated Business Income of Exempt Organizations</td>
</tr>
<tr>
<td>- <strong>Pub. 1771</strong> – Charitable Contributions Substantiation and Disclosure Requirements</td>
</tr>
<tr>
<td>- <strong>Pub. 1828</strong> – Tax Guide for Churches and Religious Organizations</td>
</tr>
<tr>
<td>- <strong>Pub. 3079</strong> – Gaming Publication for Tax-Exempt Organizations</td>
</tr>
<tr>
<td>- <strong>Pub. 3386</strong> – Tax Guide for Veterans Organizations</td>
</tr>
<tr>
<td>- <strong>Pub. 3833</strong> – Disaster Relief</td>
</tr>
<tr>
<td>- <strong>Pub. 4220</strong> – Applying for 501(c)(3) Tax-Exempt Status</td>
</tr>
<tr>
<td>- <strong>Pub. 4221-PC</strong> – Compliance Guide for 501(c)(3) Public Charities</td>
</tr>
<tr>
<td>- <strong>Pub. 4221-PF</strong> – Compliance Guide for 501(c)(3) Private Foundations</td>
</tr>
<tr>
<td>- <strong>Pub. 4302</strong> – A Charity’s Guide to Vehicle Donations</td>
</tr>
<tr>
<td>- <strong>Pub. 4303</strong> – A Donor’s Guide to Vehicle Donations</td>
</tr>
</tbody>
</table>
Other Service Resources

CE&O
Customer Education and Outreach (CE&O) is a unit that reports to the Director, Exempt Organizations. They are responsible for developing the strategic direction of the nationwide education and outreach programs for EO customers. They perform the following services:

• Deliver workshops and speeches (including “speeches-to-go”)
• Coordinate a Charities & Nonprofits page on the Internet and the Intranet
• Market and communicate EO programs, such as the release of new publications, and share information on legislative changes that affect exempt organizations
• Ensure the release of plain language forms and publications for EO

Instructor Notes
Show students how to access the folders in NERD.

National Enterprise Resource Drive (NERD)
“EO Determinations” folders are maintained on the National Enterprise Resource Drive (NERD) drive and contain information about a wide variety of topics.

The EO Determinations folder is located in the Rulings and Agreements folder within the Exempt Organizations folder. This folder:

• Serves to house internal publications
• Is a holding place for procedures not yet in the IRM
• Stores information about teams working on specific projects, and
• Provides guidance on a variety of other topics

The information contained therein can aid in case processing, provide guidance on internal operations, and reveal how tax law has been applied in other cases.

Continued on next page
Other Service Resources, Continued

| Instructor Notes | Explain that CPE articles cannot be cited as precedent, but they do indicate the Service’s position on various topics. They are a good starting point for us to research certain subject matter.  
| --- | --- |
| EO CPE Articles | In prior years, EO Technical administered the Exempt Organizations Continuing Professional Education Technical Education Program. Texts were written and published from 1979 through 2003. These texts are made up of a series of articles relating to EO tax law. In 2004, the CPE topics were written as individual articles but not published. The articles written in 2004, as well as the other published texts, are made available on the IRS Intranet and the Charities & Nonprofits section of the IRS Internet site ([www.irs.gov](http://www.irs.gov)).  
The CPE program is a tool used to maintain the highest possible level of currency and technical competence among EO specialists.  
CPE articles are for educational use only. They are not authority and may not be cited as such. They may be used as a research tool, as they contain useful tax law references for each topic, but not as a substitute for analysis and research of citable legal authority. |
In order to recommend exemption, a specialist’s justification for a determination must be based on tax law. Tax law may be very specific to a particular type of organization or applicable to more than one type of organization.

Determinations specialists base determinations on established precedent. In addition to accounting principles, the specialist must interpret tax law to determine whether applicants qualify for exemption. In determining which precedent to apply, the specialist:

- Analyzes the available facts submitted with the application for exemption
- Pinpoints the legal issues involved
- Formulates an appropriate tax question(s) to be researched
- Applies tax law to the facts of the case

The Internal Revenue Code (IRC or the Code) is the statutory foundation of all Federal tax authority, except for occasional uncodified provisions and certain international issues covered in tax treaties with foreign countries.

IRC section 7805 gives the Secretary of the Treasury or his delegate a general power to prescribe necessary rules and regulations to administer tax laws as passed by Congress. Regulations are the Treasury Department’s official interpretation of how a particular section of the Code is to be applied and, in effect, constitute an administrative extension of the law-making process.

When statutory or administrative authority alone fails to resolve a particular research problem, it may be necessary to consult judicial authority which includes United States Tax Court, U.S. District Court, U.S. Claims Court, U.S. Court of Appeals, and the U.S. Supreme Court.

Service publications include Internal Revenue Bulletins, Cumulative Bulletins, and IRS publications.

Other service resources include CE & O, Outlook Public Folders, and EO CPE Articles.
Instructor Guide - Exercise 2-1

Find the following cites in the Code and indicate on what page you found them. Write the first five words from each section:

1. Section 501(c)(3)

2. Section 170(b)(1)(A)(vi)

3. Section 512(a)(4)

4. Section 6103(b)(2)(A)

5. Section 4945(g)(2)

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Exercise 2-1 Answers:</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Image]</td>
<td>1. 2368 (July 2004) Corporations, and any community chest</td>
</tr>
<tr>
<td></td>
<td>2. 1498 (July 2004) an organization referred to in</td>
</tr>
<tr>
<td></td>
<td>3. 2390 (July 2004) Special rule applicable to organizations</td>
</tr>
<tr>
<td></td>
<td>4. 9079 (July 2004) a taxpayer’s identity, the nature</td>
</tr>
<tr>
<td></td>
<td>5. 8119 (July 2004) the grant constitutes a prize</td>
</tr>
</tbody>
</table>
Instructor Guide - Exercise 2-2

Use your regulations to complete the following:

1. Treas. Reg. 1.501(c)(3)-1(b)(1)(iv) states:
   In no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes specified in section 501(c)(3).

2. Treas. Reg. 1.501(c)(4)-1(a)(2)(i) states:
   An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Instructor Notes
Exercise 2-2 Answers:

1. **Answer:** In no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes **for which such organization is created are broader than the purposes** specified in section 501(c)(3).

2. **Answer:** An organization is operated exclusively for the promotion of social welfare **if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.** An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterment and social improvements.
Complete the following using the IRM:

1. **IRM 7.25.3.7.7(6)**
   
   An organization that provides
   
   ______________________________________________________
   
   ______________________________________________________
   
   it does not qualify for exemption.

2. **IRM 7.25.3.22.1(2)(a)**
   
   Organizations that qualify as “educational” or “charitable” can avoid the complexities of the
   
   ______________________________________________________
   
   ______________________________________________________
   

3. **IRM 7.26.3.4.6(4)**
   
   A grant that otherwise qualifies for exclusion that is paid over a period of years
   
   ______________________________________________________
   
   ______________________________________________________
   

4. What section of the IRM contains the definition of religious beliefs?

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Exercise 2-3 Answers:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.  Answer: An organization that provides educational assistance to pre-selected, specifically named individuals, it does not qualify for exemption. Rev. Rul. 67-367, 1967-2, C.B. 188.</td>
</tr>
<tr>
<td></td>
<td>2.  Answer: Organizations that qualify as “educational” or “charitable” can avoid the complexities of the “amateur athletics” provisions of IRC 501(c)(3) and IRC 501(j).</td>
</tr>
<tr>
<td></td>
<td>3.  Answer: A grant that otherwise qualifies for exclusion that is paid over a period of years may be excluded each year a payment is made. For a definition of the term “grant” see Reg. 1.509(a)-3(g).</td>
</tr>
<tr>
<td></td>
<td>4.  Answer: IRM 7.25.3.6.5(1)</td>
</tr>
</tbody>
</table>
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Chapter 3
Disclosure, UNAX, and Public Inspection

Instructor Preparation

Estimated Time 2 hours

Reference Materials
- Instructor Guide, Chapter 3, Disclosure, UNAX, and Public Inspection
- Student Guide, Chapter 3, Disclosure, UNAX, and Public Inspection
- Exhibit 3-1, TE/GE Facsimile Cover Sheet
- Exhibit 3-2, Deputy Commissioner Memorandum of 1/15/1999

Training Aids TA 3-1, Objectives

Notes to Instructor Create a flip chart of the Objectives to display throughout the chapter, or create a transparency using TA 3-1.
Chapter 3
Objectives

After completing this chapter you will be able to:

- Define disclosure

- Determine whether Service employees can disclose taxpayer information

- Define UNAX

- Distinguish the difference between disclosure and UNAX

- Identify the public inspection requirements
• Identify misconduct which may result in termination under the Restructuring and Reform Act of 1998

• Determine who may represent a taxpayer and in what capacity

• Determine whether a Power of Attorney (POA)/Taxpayer Information Authorization (TIA) is complete and valid

• Process the POA/TIA

• Initiate action to add a POA/TIA to the CAF system on IDRS
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Chapter 3
Disclosure, UNAX, and
Public Inspection

Overview

Instructor Notes
Tell the students to use caution with any information related to an application for exemption to avoid any unauthorized disclosure of information that has been provided to them.

Introduction

It is the expectation of U.S. citizens that the Service will keep their information confidential. For that purpose, the Service is ensuring through training and awareness activities that all employees understand what unauthorized access is all about.

Under IRC section 6103(a), Service employees are prohibited from disclosing taxpayer information to unauthorized individuals.

The Taxpayer Browsing Protection Act was signed into law on August 5, 1997. The willful unauthorized access and inspection of taxpayers’ records is referred to as UNAX. Service employees are prohibited from browsing, and if they do they are subject to substantial penalties.

IRC section 6110(a) provides that the text of any written determination and any background file document relating to such written determination shall be open to public inspection.

The IRS Restructuring and Reform Act of 1998 (RRA-98) put into law the Commissioner’s Concept for Modernizing the IRS. The law affects a wide range of activities, with emphasis on serving the public and meeting taxpayer needs. Section 1203 of the Act identifies offenses for which Service employees can be terminated.

Continued on next page
Overview, Continued

Objectives

After completing this chapter you will be able to:

• Define disclosure
• Determine when Service employees can disclose taxpayer information
• Define UNAX
• Distinguish the difference between disclosure and UNAX
• Identify the public inspection requirements
• Recognize misconduct which may result in termination under the Restructuring and Reform Act of 1998
• Determine who may represent a taxpayer and in what capacity
• Determine whether a Power of Attorney (POA)/Taxpayer Information Authorization (TIA) is complete and valid
• Process a POA/TIA
• Initiate action to add a POA/TIA to the CAF system on IDRS

Instructor Notes

Display and discuss the Objectives, or a review, on the flip chart.

Inform Students that disclosure will be a recurring theme throughout their career with the Service.

In This Chapter

This chapter contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
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</tr>
<tr>
<td>Disclosure Defined</td>
<td>3</td>
</tr>
<tr>
<td>Disclosure Situations</td>
<td>5</td>
</tr>
<tr>
<td>Unauthorized Access and Inspection of Taxpayer Records</td>
<td>7</td>
</tr>
<tr>
<td>Unauthorized Access and Inspection of Taxpayer Records</td>
<td></td>
</tr>
<tr>
<td>(UNAX)</td>
<td></td>
</tr>
<tr>
<td>Public Inspection</td>
<td>9</td>
</tr>
<tr>
<td>The IRS Restructuring and Reform Act of 1998 (RRA-98)</td>
<td>13</td>
</tr>
<tr>
<td>Practice Before the Service</td>
<td>16</td>
</tr>
<tr>
<td>Power of Attorney/Taxpayer Information Authorization</td>
<td>20</td>
</tr>
<tr>
<td>Types of POAs</td>
<td>24</td>
</tr>
<tr>
<td>Centralized Authorization File</td>
<td>25</td>
</tr>
<tr>
<td>Summary</td>
<td>27</td>
</tr>
<tr>
<td>Exhibit 3-1: TE/GE Facsimile Cover Sheet</td>
<td>29</td>
</tr>
<tr>
<td>Exhibit 3-2: Deputy Commissioner Memorandum of 1/15/99</td>
<td>31</td>
</tr>
</tbody>
</table>
# Disclosure Defined

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Have students look up IRC Section 6103(a).</td>
</tr>
<tr>
<td>Walk through relevant sections of Forms 1023 and 1024 to show where authorized individuals will be listed.</td>
</tr>
<tr>
<td>Provide examples of disclosure based on your experience and give a general awareness of who is authorized to receive information and who is not authorized to receive information regarding an application for exemption.</td>
</tr>
<tr>
<td>Most specialists run into trouble when they try to contact a director and they are not available, but their spouse wants to discuss the case. The spouse is routinely an unauthorized person.</td>
</tr>
<tr>
<td>If a designated contact person from Part 1 of Form 1023/1024 is not an officer, director, or POA – see your manager. This can be a controversial area. If the applicant did not want you to discuss the case with them, why did they list them on the application? Some managers may prefer you to answer general questions from the contact person, but not reveal specific taxpayer data.</td>
</tr>
</tbody>
</table>

The Code Prohibits Disclosure to Unauthorized Individuals

IRC section 6103(a) prohibits Service employees from disclosing taxpayer information to unauthorized individuals.

An improper disclosure would include sharing any taxpayer information with an unauthorized third party.

Accountants, attorneys, and exempt organization officers and members frequently submit applications for exemption on behalf of nonprofit organizations. These same individuals frequently call to check on the status of an application and/or to request information about the organization.

Form 1023, Part I, item 6, and Form 1024, Part I, item 3, both request a name and telephone number of a person to be contacted if additional information is needed.

The determinations specialist must ensure that only authorized individuals are contacted for additional information. We can accept relevant information from anyone, but we can only disclose information to authorized individuals.

*Continued on next page*
Disclosure Defined, Continued

The Code Prohibits Disclosure to Unauthorized Individuals (continued)

Authorized individuals include:

- An officer of the applicant organization
- A board member of the applicant organization
- An authorized power of attorney on Form 2848
- An authorized person listed on Form 8821, Tax Information Authorization

You may also contact the person listed on page 1 of the Form 1023 or 1024 as the person to contact to secure information or to inquire as to the status of responses. This would not be a third party contact. However, if you think the case may be adverse, you should secure a Form 2848 or 8821 for the contact person or request that the contact person refer you to an officer or board member of the organization. In this case, do not reveal to that individual that the case may be adverse.

Unless you are satisfied that only an authorized person can access the medium, you should not disclose confidential taxpayer information in a voice message. For example, you should ensure that the voice mail message identifies the authorized person by name.

Instructor Notes

Disclosure Officer for EO is Ava Littlejohn Phone # 513-263-3084.

Disclosure Officer

Each IRS office has a designated individual to whom questions and particular situations about disclosure may be directed. If you have any doubt about the legality of a particular disclosure, the Disclosure Officer for your office will be able to assist you. Consult your group manager before contacting the Disclosure Officer.
Disclosure Situations

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that when you call an organization, you should call an officer or authorized representative. The person called should be recorded on the CCR by first and last name.</th>
</tr>
</thead>
</table>
| Telephone Contacts | When speaking on the telephone, you should confirm that you are speaking to an authorized person.  
• Ask sufficient questions to identify the person on the phone  
• Confirm their right to receive confidential taxpayer information |
| Instructor Notes | Explain that we do not communicate with customers by e-mail.  
If leaving a message on an answering machine that does not identify an authorized person by name, only leave your name, ID# and phone #, and identify yourself as an EO Determination Specialist with the IRS. |
| Voice Mail/Answering Machines | Unless you are satisfied that only an authorized person can access the medium, you should not disclose confidential taxpayer information in a voice message. For example, you should ensure that the voice mail message identifies the authorized person by name. |
| Instructor Notes | Explain that additional information requests can be faxed in order to expedite processing.  
Refer to Exhibit 3-1. We meet the disclosure requirements if we use this cover sheet. |
| Fax Machines | Usually fax machines are not secure and access is not limited to persons authorized to receive confidential taxpayer information. At a minimum, include a cover sheet (Exhibit 3-1) which:  
• Identifies the recipient  
• Shows the number of pages being transmitted  
• Contains necessary language warning unauthorized persons how to handle the material should they accidentally come in contact with it |

*Continued on next page*
### Disclosure Situations,  Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that Flexiplace is a program that allows employees to work at home. They will not be eligible until they are either 1) at the journeyman level, or 2) have reached 2 years of service, whichever comes first. They must also be rated as fully successful.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flexiplace Concerns</td>
<td>You must take adequate precautions to ensure that friends or family members cannot hear or see confidential taxpayer information. Do not leave CDs, files, or documents where others can access them.</td>
</tr>
<tr>
<td>Instructor Notes</td>
<td>Stress that information should be shared on a “need-to-know” basis. Cases can be discussed with the group manager, OJI, or peers (when assistance is needed). Also in group meetings for discussion purposes.</td>
</tr>
<tr>
<td>Other Employees</td>
<td>Disclosure to other employees should only be made on a “need to know” basis. Common sense steps should be taken to achieve reasonable privacy when discussing protected information in an office setting.</td>
</tr>
<tr>
<td>Reporting Disclosure</td>
<td>Employees must report inadvertent unauthorized disclosures directly to their group manager who, in turn, must report them to the local Disclosure Office. Form 10848, <em>Report of Inadvertent Disclosure of Tax And Privacy Act Information</em>, is used for this purpose.</td>
</tr>
<tr>
<td>IRM 7.20.1.7</td>
<td>For more information refer to IRM 7.20.1.7, which gives additional guidance on Disclosure/Third Party Contacts.</td>
</tr>
</tbody>
</table>
Unauthorized Access and Inspection of Taxpayer Records (UNAX)

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain the purpose of the Taxpayer Browsing Protection Act.</td>
</tr>
<tr>
<td>Note that all IDRS research requested should be pertinent and vital to the case the student is working.</td>
</tr>
<tr>
<td>Remind students that specialists do not have IDRS access. This separation of duties eliminates the temptation to access sensitive taxpayer data.</td>
</tr>
<tr>
<td>Overhead question – what is the difference between UNAX and disclosure?</td>
</tr>
<tr>
<td>Have students complete Exercise 3-1</td>
</tr>
</tbody>
</table>

UNAX Defined

On August 5, 1997, President Clinton signed the Taxpayer Browsing Protection Act into law. Under the new law:

- Willful unauthorized access or inspection of non-computerized taxpayer records, including hard copies of returns, as well as computerized information, is a misdemeanor, punishable upon conviction by fines, prison terms, and termination of employment.

- Taxpayers have the right to take legal action when they are victims of unlawful access or inspection, even if a taxpayer’s information is never revealed to a third party.

- When managers or employees are criminally charged, the Service is required to notify taxpayers that their records have been accessed without authorization.

Willful unauthorized access or inspection of taxpayer records is referred to as UNAX. In all substantiated cases of UNAX, the appropriate managerial response, absent any mitigating circumstances, will be removal.

- Disclosure occurs when Service employees release confidential taxpayer information to unauthorized third parties.

- UNAX occurs when Service employees access taxpayer information without a work related reason, whether or not the information is disclosed to unauthorized third parties.

Continued on next page
**Unauthorized Access and Inspection of Taxpayer Records (UNAX), Continued**

<table>
<thead>
<tr>
<th>Investigation of UNAX Violations</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Office of the Treasury Inspector General for Tax Administration (TIGTA) has responsibility for investigating all allegations of possible UNAX.</td>
</tr>
<tr>
<td>- Any employee who has knowledge of a UNAX violation should immediately contact the local TIGTA office, or call the TIGTA Hotline at 1-800-366-4484.</td>
</tr>
<tr>
<td>- TIGTA also maintains a website at: <a href="http://www.treas.gov/tigta">www.treas.gov/tigta</a></td>
</tr>
</tbody>
</table>
Public Inspection

Instructor Notes

Use the Code to find sections 6104 and 6110.

Background

IRC section 6103 provides the general rules regarding the confidentiality of all tax returns and tax return information. In the absence of other specific Code disclosure authorization, tax returns and tax return information are confidential.

IRC section 6103 itself contains exceptions to the rule that tax returns and tax return information are confidential. Furthermore, there are two major statutory exceptions that govern the public disclosure of Exempt Organizations (EO) tax information. The exceptions are as follows:

- IRC section 6104 sets forth specific rules for the disclosure of EO applications, rulings, determinations, and returns.
- IRC section 6110 sets forth special disclosure rules and procedures for certain categories of rulings, determinations, and technical advice memorandums.

Continued on next page
**Public Inspection, Continued**

| Instructor Notes | Once approved, the application is open to public inspection (right side of file).

Tax Analysis – before 2003, denials were not considered “written determinations” by the Service, so they were not open to public inspection.

Overhead question – if you were considering donating money to a public charity, could you request the case file history (DVD) and review the full application? No, left side of file is not open to public inspection. Also, not a work-related reason. |

| **Public Inspection Is Required** | IRC section 6110(a) provides, “Except as otherwise provided in this section, the text of any written determination and any background file document relating to such determination shall be open for public inspection at such place as the Secretary may by regulations prescribe.”

IRC section 6110(b)(1) states, “The term ‘written determination’ means a ruling, determination letter, or technical advice memorandum.”

Once a determination letter has been issued, it is not uncommon for the general public to request copies of the application, supporting documents within the file, and the determination letter. This is permitted per IRC section 6110(a) and is not a disclosure issue. However, a file is not open for public inspection prior to the time a written determination is made.

Until recently, the regulations provided an exception for public disclosure of EO denials and revocations. However, on December 2, 2003, the D.C. Circuit Court ruled in *Tax Analysts v. Internal Revenue Service*, 350 F.3d 100 (D.C. Cir. 2003), that the Service must disclose EO denials and revocations under IRC section 6110. Prior to disclosure of information, the determination letter, application, and supporting documentation is redacted to remove identifying information about the applicant. For example, the name, address, and unique identifiers would be removed prior to disclosing information. |

*Continued on next page*
### Public Inspection, Continued

**Public Inspection is Required**

**Example:**
An organization’s application for exemption under IRC section 501(c)(3) was approved in 1982. The organization is completely run by volunteers and since 1982 many volunteers have come and gone. In January 1998, Grant Fremont was elected treasurer of the organization. Mr. Fremont cannot find any record of his organization’s exemption. He contacted the Service to confirm its exemption and requested a copy of the application and determination letter.

This would be appropriate per IRC section 6110(a) and a copy of the Form 1023 application and determination letter would be provided to Mr. Fremont.

### Exempt Organization Public Inspection Requirements

Once an organization has had its application for exemption approved, it has certain public inspection requirements. These requirements are detailed in IRC section 6104 and IRM 11.3.9.

For example, if the organization is not a private foundation it must have the following items open for public inspection, if filed:

- Form 990, *Return of Organization Exempt From Tax*. The returns must be made available for a three-year period.
- Form 990-T, *Exempt Organizations Business Income Tax Return*, if filed after August 17, 2006, also for a three-year period
- A copy of the Form 1023 or Form 1024 and any papers provided in support of such application
- A copy of the determination letter

### Place of Inspection

If the organization does not maintain a permanent office and it receives a request for its annual returns and application for exemption, it must provide the requester with an opportunity to inspect the material at a reasonable location of the organization’s choice.

*Continued on next page*
**Public Inspection, Continued**

<table>
<thead>
<tr>
<th>Time of Inspection</th>
<th>The required information should normally be available on the day of the request for inspection and during normal business hours of the organization’s office. In exceptional circumstances where an organization has no office, or where the office has very limited hours during certain times of the year, the required information should be made available within a reasonable amount of time (not normally more than two weeks) and at a reasonable time of day.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Penalties</td>
<td>Any organization who fails to comply with the public inspection requirement for annual returns and applications for exemption may be assessed a penalty of $20 per day for each day during which the failure to comply continues. The maximum penalty on all persons for failure to comply with respect to any one annual return is $10,000. No penalty will be assessed if the failure is due to reasonable cause.</td>
</tr>
</tbody>
</table>
The IRS Restructuring and Reform Act of 1998

Background
The IRS Restructuring and Reform Act of 1998 (RRA-98) was signed by the President on July 22, 1998. The law affects a wide range of Service activities. It also specifies that the Service restate its mission to place emphasis on serving the public and meeting taxpayer needs.

Penalties for Misconduct
Section 1203 of RRA-98 was enacted in response to the perception that Service employees are not held fully accountable for improper conduct affecting taxpayers. It provides that Service employees must be charged with misconduct and terminated if there has been a judicial or final administrative determination that the employee committed any of the following acts or omissions:

1. Willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets;
2. Providing a false statement under oath with respect to a material matter involving a taxpayer or taxpayer representative;
3. Violating the rights of a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service, under the Constitution of the United States or under specified civil rights acts;
4. Falsifying or destroying documents to conceal mistakes made by any employee with regard to a matter involving a taxpayer or taxpayer representative;
5. Assault or battery on a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service, but only if there is a criminal conviction, or a final judgment to that effect;

Continued on next page
Penalties for Misconduct (continued)

6. Violations of the Internal Revenue Code of 1986, Treasury Regulations, or IRS policies (including the Internal Revenue Manual) for the purpose of retaliating against or harassing a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service;

7. Willful misuse of the provisions of IRC section 6103 (regarding confidentiality of returns and return information) for the purpose of concealing information from a congressional inquiry;

8. Willful failure to file any return of tax required under the Internal Revenue Code on or before the required date, unless the failure is due to reasonable cause and not to willful neglect;

9. Willful understatement of Federal tax liability, unless such understatement is due to reasonable cause and not to willful neglect;

10. Threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

The offenses established in the Act are serious offenses, but are not different from actions already defined as misconduct. The Service now has, and will continue to have processes that allow employees accused of misconduct to participate in any proceeding, whether it is administrative or judicial, to determine whether the offense was committed and what the facts of the situation are. While RRA-98 doesn’t create new offenses, it does create serious penalties for people who are found to have committed these offenses.

Continued on next page
The IRS Restructuring and Reform Act of 1998, Continued

Instructor Notes
Refer to Exhibit 3-2.

Employee Contacts
Effective January 22, 1999 (See Exhibit 3-2), when working tax related issues, you must provide all of the following information:

- **During a Telephone or Personal Contact (including walk-in):**
  your title (e.g. Mr., Ms.), last name, and identification ID Card (badge) number.

- **On Manually Generated and Handwritten Correspondence:**
  your title (e.g. Mr., Ms.), last name, and generated IDRS or other unique letter system number. If an IDRS/unique number is not generated, use your ID Card (badge) number.

- **On All Correspondence:**
  a telephone number (local, toll free, or both) where the taxpayer’s question can be answered.

The ID Card (badge) generally refers to an employee’s Smart Card.

Instructor Notes
Indicate to students that due to the nature of our work, pseudonyms are generally not used.

Pseudonyms
While the use of pseudonyms is still possible, their use will be restricted to situations that are fully justified, such as when an employee’s personal safety has been threatened. Management must approve the use of a pseudonym in advance of its use. If a pseudonym is approved for use, the employee will provide the taxpayer with the pseudonym, his or her telephone number, and add the letter “P” to his or her ID Card (badge) number. Under no circumstances will the name of an employee using a pseudonym be disclosed.
Practice Before the Service

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain to students how to access Circular 230 through the Internet.</td>
</tr>
</tbody>
</table>

Oversight

The office of the Director of Practice, IRS, has oversight for the regulations in Treasury Department Circular No. 230 concerning practice before the Service. That oversight responsibility includes making determinations on applications for enrollment to practice and conducting disciplinary proceedings relating to those allowed to practice.

Types of Presentations Permitted

Practice before the Service, as defined in Circular No. 230, includes all matters connected with presentations to the Service relating to a taxpayer’s rights, privileges, and liabilities under laws or regulations administered by the Service. These presentations include:

- The preparation and filing of necessary documents for a taxpayer whose return is under examination
- Communication with the Service (presenting and receiving information)
- The representation of a taxpayer at conferences, hearings, and meetings

Note: Preparing a tax return, appearing as a witness, or furnishing information at the request of the Service is not considered practice before the Service.

Continued on next page
Practice Before the Service, Continued

Qualified Individuals

The rules of practice grant the right to practice before the Service to qualified individuals. They also impose duties and restrictions on them. The practice requirements are intended to ensure that:

- Only technically qualified individuals who abide by our standards of conduct represent taxpayers before the Service, and
- A representative has been authorized by the taxpayer to act on their behalf

Note: This authorization is implied by the presence of the taxpayer at conferences or conference calls. If the taxpayer is not present, a written authorization is required.

Instructor Notes

Write the list of qualified practitioners from 3-12 on the whiteboard.

Explain your personal experiences dealing with the various representatives.

Qualified Practitioners

Sometimes organizations authorize others to represent them when they apply for exemption. The following persons may practice before the Service:

- Attorney
- Certified Public Accountant
- Enrolled Agent
- An officer of the applicant organization
- A full-time employee of the applicant organization
- An Enrolled Actuary
- An unenrolled return preparer

Attorneys and CPAs must be qualified to practice in their respective states and must not be currently under suspension or disbarment from practice before the Service.

The Director of Practice may suspend an attorney, a CPA, or an enrolled agent. If suspended, they are prohibited from practicing before the Service.

Continued on next page
Practice Before the Service, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that if information is provided to a person who is suspended, it would constitute a disclosure violation.</th>
</tr>
</thead>
</table>
| Suspensions      | The Internal Revenue Bulletin, which is a weekly publication of the official rulings and procedures of the Service, provides a list of the names and addresses of practitioners who have been suspended.  

The announcement will appear in the weekly bulletin at the earliest practicable date after such action and will continue to appear in the weekly bulletin for five successive weeks.  

After that period of time, these lists will be consolidated and published in the Cumulative Bulletin. |
| Office of Professional Responsibility | The Office of Professional Responsibility maintains a website containing a feature to search for suspended individuals by last name, first name, and other criteria at: [http://nhq.no.irs.gov/OPR/Practice/SCDefault.asp](http://nhq.no.irs.gov/OPR/Practice/SCDefault.asp) |
Practice Before the Service, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>URPs can act as contact persons, but not POAs. We can discuss tax matters with them, but not accept their answers in writing.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Unenrolled Return Preparers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rev. Proc. 81-38, 1981-2 C.B. 592, provides that unenrolled agents are permitted to represent taxpayers before the Examination Division only. In other words, we will not recognize a power of attorney submitted by an unenrolled agent if he/she is representing an organization applying for exemption from Federal income tax.</td>
</tr>
</tbody>
</table>

**Example:**
An attorney is disbarred and subsequently suspended from practice before the Service by the Director of Practice. The attorney then submits a Form 1023 on behalf of an applicant organization. He attaches a Form 2848, *Power of Attorney and Declaration of Representative*. Form 2848 is signed by both the suspended attorney and an officer of the applicant organization. Form 2848, Part II, Declaration of Representative, indicates that the representative is acting in the capacity of an unenrolled preparer. Per Rev. Proc. 81-38, we would not recognize the representative as having power of attorney.

<table>
<thead>
<tr>
<th>Authorization</th>
</tr>
</thead>
<tbody>
<tr>
<td>In addition to being eligible to practice or exercise limited practice before the Service, the representative must be authorized by the taxpayer (applicant organization). This authorization may take two forms:</td>
</tr>
</tbody>
</table>

1. If the individual appears with the taxpayer at a conference or teleconference, the taxpayer is considered to have authorized disclosure of information to that person.

2. The taxpayer may provide the eligible individual with written authorization to represent them. This may be accomplished on Form 2848, *Power of Attorney and Declaration of Representative*, or Form 8821, *Tax Information Authorization*, both discussed in the next section. |

<table>
<thead>
<tr>
<th>Pub 947</th>
</tr>
</thead>
<tbody>
<tr>
<td>For more detailed information concerning practice before the Service, consult Publication 947, <em>Practice Before the IRS and Power of Attorney</em>.</td>
</tr>
</tbody>
</table>
Power of Attorney/Taxpayer Information Authorization

Introduction

Sometimes, applicant organizations request that attorneys, CPAs, or other tax practitioners represent them during the application process.

Applicant organizations do have the right to designate other individuals to act on their behalf.

All information contained in applications for exemption is confidential. The determinations specialist has an obligation and a responsibility to ensure that case file information is only shared with authorized individuals.

The determinations specialist should determine the acceptability of the credentials and powers of attorney presented by the taxpayer’s representative.

Instructor Notes

Pass out blank Form 2848 and Form 8821.

IRS POA Forms

Form 2848, Power of Attorney and Declaration of Representative, and Form 8821, Tax Information Authorization, are designed to meet the Service’s requirements.

- The use of these forms is not mandatory.
- These two forms are the only POAs the Service will process onto the Centralized Authorization File (CAF).

Continued on next page
Go over the parts of Form 2848 and 8821 and what is required.

Upon receipt, the POA/TIA must be date stamped and reviewed for accuracy and completeness. The following elements must be present:

- Name of organization, address, and employer identification number (EIN)
- Name and address of representative/appointee. For a POA, it is not sufficient to provide only the representative’s firm name. A specific person must be included. A TIA may authorize a person, corporation, firm, partnership, or other organization.
- Type of taxes (a general reference to “all taxes” is not acceptable)
- Federal tax form numbers
- Tax years or periods (a general reference to “all years” or “all periods” is not acceptable)
- Taxpayer signature and date (dated within 60 days of receipt for TIA)
- Representative’s declaration, signature, and date (POA only)

Continued on next page
Power of Attorney/Taxpayer Information Authorization Form, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that if any of the required information is missing, the form is invalid.</th>
</tr>
</thead>
</table>

Incomplete Authorizations

If any of the above items are missing, the Form 2848/8821 is invalid. The invalid document normally may be converted to a valid document by securing the missing information. All information may be obtained from the representative except for the taxpayer’s signature and date.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Form 2848 – we don’t send correspondence to more than two representatives</th>
</tr>
</thead>
</table>

Note – POA is not authorized to sign Form 1023 (on page 12). They may sign correspondence, but we cannot accept their signature for the perjury statement.

Form 2848

Form 2848, *Power of Attorney and Declaration of Representative*, can be used to grant authority to an individual to represent an applicant organization and to receive tax information and copies of all correspondence.

Form 8821

Form 8821, *Tax Information Authorization*, authorizes any individual, corporation, firm, organization or partnership designated by the applicant organization to inspect and/or receive confidential information and receive copies of all correspondence.

*Continued on next page*
Instructor Notes

Be wary of any non-IRS POA authorizations. Make sure they contain all of the information required on Form 2848. Usually they are lacking information and the best solution is to send them a blank 2848 and have them fill it out.

Non-IRS POA Forms

There are other specific types of powers of attorney besides Form 2848, Power of Attorney and Declaration of Representative, that can be equally valid.

We will accept non-IRS authorizations that are either a “general” or “durable” POA executed in accordance with state requirements. These POAs customarily grant authority to the representative to handle any and all legal matters for the taxpayer.

IRM 7.20.1.5

For more information refer to IRM 7.20.1.7, which gives additional guidance on Authorized Persons.
### Types of POAs

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>General POA</td>
<td>The General POA is a document by which the attorney-in-fact is authorized to perform any or all acts the taxpayer can perform. This type of authorization is executed in accordance with State requirements.</td>
</tr>
<tr>
<td>Durable POA</td>
<td>The Durable POA is a document which specifies that the appointment of the attorney-in-fact will not end due to either the passage of time (e.g., the death of the taxpayer) or the incompetency of the taxpayer (e.g., the taxpayer becomes unable or is adjudged incompetent to conduct his business affairs).</td>
</tr>
<tr>
<td>Limited POA</td>
<td>The limited POA is a document that authorizes the attorney-in-fact to perform only certain specified acts. Form 2848 is a type of limited POA. Any person not authorized to practice before the Service cannot act as a representative. However Form 8821, <em>Tax Information Authorization</em>, can be used to authorize any person or organization to receive and inspect confidential tax return information under the provisions of IRC section 6103. Other authorizations not on Form 8821 will be accepted for release of information provided they conform to IRC section 6103 requirements. They should always be retained in the case file.</td>
</tr>
</tbody>
</table>
Centralized Authorization File (CAF)

Instructor Notes

Explain that the CAF for EO Determinations is updated by the Ogden Service Center.

CAF

Information regarding the authority of an individual appointed under POA, Form 2848, or person designated under a TIA, Form 8821, is recorded onto the Centralized Authorization File (CAF). Recording such information onto the CAF facilitates automatic routing of tax notices and correspondence to a representative or designee. However, recognition of the validity of a POA or TIA is not contingent on the entry of such information onto the CAF.

The CAF file is a nationwide computerized system of records that houses authorization information from both powers of attorney and TIAs. The CAF system contains two types of records:

- Taxpayer records (CAFT)
- Representative records (CAFR)

Powers of attorney relating to determination applications are no longer processed in the CAF system. The CAF system is used only for the processing of powers of attorney relating to exam cases.
Centralized Authorization File (CAF), Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Go over current procedures to add a POA to the CAF.</td>
</tr>
<tr>
<td>If only representation is for Forms 1023/1024, do not add to CAF.</td>
</tr>
<tr>
<td>Write the required information (as written on second page of Form 2848 on the whiteboard – Name, TEGE, etc.)</td>
</tr>
<tr>
<td>Have the students complete Exercise 3-2.</td>
</tr>
</tbody>
</table>

**Add a POA to CAF**

When an applicant designates a power of attorney to represent them on a tax or information return such as Form 990, 990-T, 990-PF, 941, 940, or other tax return, the specialist will send the original Form 2848 to the Adjustments Unit to be input into the Centralized Authorization File (CAF). The specialist will indicate the following information under the representative’s signature:

- Name, TEGE, Group #, Phone #, POD, MM/DD/YYYY
- Sent to EP/EO Adjustments Unit

The specialist should make a photocopy of Form 2848 for the case file before sending the original to the Adjustments Unit.

**Examples**

- An attorney submits a Form 2848 with Form 1023. Form 2848, Part II, section 3 (Tax Matters) specifies Form 1023 only. The Form 2848 would not be processed onto the CAF system.

- If in the above example, the attorney also listed Form 990 in section 3, the determinations specialist would photocopy Form 2848 for the determination file and send the original Form 2848 to the Adjustments Unit to be added to the CAF system.
Summary

It is the expectation of U.S. citizens that the Service will keep their information confidential. For that purpose, the Service is ensuring through training and awareness activities that all employees understand what unauthorized access is all about.

IRC section 6103(a) prohibits Service employees from disclosing taxpayer information to unauthorized individuals. An improper disclosure would include sharing any taxpayer information with an unauthorized third party. Willful unauthorized access or inspection of taxpayer records is referred to as UNAX and may lead to removal.

IRC section 6103 provides the general rules regarding the confidentiality of all tax returns and tax return information. There are two major statutory exceptions that govern the public disclosure of Exempt Organizations (EO) tax information. The exceptions are as follows:

- IRC section 6104 sets forth specific rules for the disclosure of EO applications, rulings, determinations, and returns.
- IRC section 6110 sets forth special disclosure rules and procedures for certain categories of rulings, determinations, and technical advice memorandums.

Practice before the Service, as defined in Circular No. 230, includes all matters connected with presentations to the Service relating to a taxpayer’s rights, privileges, and liabilities under laws or regulations administered by the Service.

Applicant organizations have the right to designate other individuals to act on their behalf which generally are attorneys, CPAs, or other tax practitioners. These individuals generally complete Form 2848, Power of Attorney and Declaration of Representative, and Form 8821, Tax Information Authorization, which are designed to meet the Service’s requirements but are not mandatory.

Information regarding the authority of an individual appointed under POA, Form 2848, or person designated under a TIA, Form 8821, is recorded onto the Centralized Authorization File (CAF). Recording such information onto the CAF facilitates automatic routing of tax notices and correspondence to a representative or designee. However, recognition of the validity of a POA or TIA is not contingent on the entry of such information onto the CAF.
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We are reviewing your application for a favorable determination letter on the above referenced application. However, we need more information before we can continue the process. The content of this fax requests the additional information needed and, if applicable, changes and/or amendments to be submitted.

Please send your reply by the response date to the address/fax listed below with a copy of this cover sheet. If you have any questions or cannot meet the response date, please contact the person whose name and phone number are shown above. Please call between the hours of 8:30 a.m. and 4:30 p.m. (E.S.T.)

For forms/information see the IRS Web site at [www.irs.gov](http://www.irs.gov) to download forms, instructions and publications

Comments:

Mailing Address
TE/GE Division
P.O. Box 2508
Cincinnati, OH 45201
Attn: , Gr. XXXX

Fax Numbers*
(513) 263-XXX
(513) 263-XXX

Office Delivery
TE/GE Division
F.O.B. Room *****
550 Main Street
Cincinnati, OH 45202
Attn: , Gr. XXXX

*Please DO NOT fax the additional information requested if it is more than 10 pages.

This communication is intended for the sole use of the individual to whom it is addressed and may contain information that is privileged, confidential and exempt from disclosure under applicable law. If the reader of this communication is not the intended recipient or the employee or agent for delivering the communication to the intended recipient, you are hereby notified that any dissemination, distribution, or copying of this communication may be strictly prohibited. If you have received this communication in error, please notify the sender immediately by telephone, and return the communication at the address via the United States Postal Service. Thank you.
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MEMORANDUM FOR ALL EMPLOYEES

FROM: Bob Wenzel /s/ Bob Wenzel
Deputy Commissioner Operations

SUBJECT: Providing Taxpayers With Internal Revenue Service Employee Contacts

The purpose of this memorandum is to inform all employees working tax related issues (not administrative or personnel) of new procedures required by Section 3705(a) of the Internal Revenue Service Restructuring and Reform Act of 1998. Act Section 3705(a) defines when you will provide taxpayers your name, telephone number, and unique identifying number. The purpose is to give taxpayers enough information to be able to contact you with any further questions regarding their discussion or correspondence with you.

Effective January 22, 1999, when working tax related issues, you must provide all the following information:

**During a Telephone or Personal Contact (including Walk-In):**
your title (e.g., Mr., Ms.), last name, and identification (ID) Card (badge) number.

**On Manually Generated and Handwritten Correspondence:**
your title (e.g., Mr., Ms.), last name, and generated Integrated Data Retrieval System (IDRS) or other unique letter system number. If an IDRS/unique number is not generated, use your ID Card (badge) number.

**On All Correspondence:**
a telephone number (local, toll-free, or both) where the taxpayer's questions can be answered.

If you have an approved pseudonym, add a "P" to the end of the ID Card (badge) number. The ID Card (badge) number refers to an employee's building pass and not the number on enforcement shields or commissions.

The appropriate Internal Revenue Manuals are being updated.

I appreciate your support in making this important change in our procedures.
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Drew Bates was inducted into the National Baseball Hall of Fame. During his acceptance speech, Mr. Bates mentioned that he planned to start a foundation to educate youth about the harmful effects of drugs. One week later, the foundation was formed and it applied for exemption under IRC section 501(c)(3).

Dawson Evans, an exempt organization determinations specialist, was assigned to the case. Mr. Evans reviewed the case file and wrote the foundation to request additional information. Drew Bates called Dawson Evans to discuss the additional information letter. During the telephone conversation Mr. Evans mentioned that his son, Franklin, was a big fan.

Drew Bates included an autographed baseball with his reply to the additional information letter. Later at a family outing, Franklin was showing off the autographed ball to his cousins. When asked how he got the ball, Dawson told his family that Drew Bates is establishing an exempt organization through his office and is doing good things for youth.

What, if any, disclosure or ethical issues are raised in this example?

Suggestions: Ethical - Acceptance of taxpayer gift & giving to son; Disclosure - discussing case with family

Using the same facts above, Forrest Harper, an exempt organization determinations specialist, is in Dawson Evans’ group. Mr. Harper is an avid baseball fan and he watched Drew Bates’ induction into the Baseball Hall of Fame on television.

One day when Dawson Evans was gone to lunch, Forrest Harper happened to see the Dawson Bates Foundation file on Mr. Evans’ desk. Having followed Mr. Evans’ career, Mr. Harper was curious, so he spent his lunch time reading the file. Mr. Harper did not share information from the file with anyone. Though he is authorized to work exempt organization applications, this file was not assigned to him and he had no official business reason to look at the file.

What, if any, disclosure or ethical issues are raised in this example?

Suggestions: Ethical – Looking at information without “need to know;” Disclosure – leaving case file out and unattended. UNAX – access of taxpayer information without a work related reason. NOTE: Section 6104 permits disclosure of tax information to officers and employees of the Service whose official duties require the disclosure for tax administration purposes. This section authorizes access to tax information when the employee establishes a “need to know” to perform a tax administration function. For example, EO Specialist A was assigned a case involving a questionable management contract. EO Specialist A requested general assistance from Senior EO Specialist B. It was discovered that Senior EO Specialist B was also working on a group of cases with similar questionable management contacts. Senior EO Specialist B may share tax information on the “need to know” basis in order to assist EO Specialist A and ensure consistency.
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Instructor Guide - Exercise 3-2

The general public has the right to disclosure of any Form 1023 during processing.

(a) True    (b) False

**Answer: False** An application is open to general public disclosure only **after** exemption under 501(a) is granted (IRC 6104(a)(1)(A)).

Violating the rights of a taxpayer may result in termination of employment under the provisions of section 1203.

(a) True    (b) False

**Answer: True** Section 1203 of the IRS Restructuring and Reform Act of 1998 (RRA-98) provides that Service employees must be charged with misconduct and terminated if there has been a judicial or final administrative determination that the employee committed any of the specified acts or omissions such as falsifying or destroying documents to conceal mistakes made by any employee with regard to a matter involving a taxpayer or taxpayer representative or providing a false statement under oath with respect to a material matter involving a taxpayer or taxpayer representative.

Which of the following do you not have to provide when identifying yourself to a customer?

Name
Location
Title
ID Number

**Answer: (b) Location** During a Telephone or Personal Contact (including walk-in) you must provide your title (e.g. Mr., Ms.), last name, and identification ID Card (badge) number. On Manually Generated and Handwritten Correspondence: your title (e.g. Mr., Ms.), last name, and generated IDRS or other unique letter system number. If an IDRS/unique number is not generated, use your ID Card (badge) number.

An organization may only authorize representation on Form 2848.

(a) True    (b) False

**Answer: False** Representation may be authorized in written form on Forms 2848 or other “general” or “durable” POAs executed in accordance with state requirements. An organization may authorize a representative to receive information on Form 8821.
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# Chapter 4

## Introduction to IRC Section 501(c)(3) and the Organizational Test

### Instructor Preparation

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>4 hours</th>
</tr>
</thead>
</table>

### Reference Materials
- Instructor Guide, Chapter 4, *Introduction to IRC Section 501(c)(3) and the Organizational Test*
- Student Guide, Chapter 4, *Introduction to IRC Section 501(c)(3) and the Organizational Test*
- Exhibit 4-1: *Rev. Proc. 68-14*, 1968-1 C.B. 768
- Exhibit 4-2: *Declaration*
- Exhibit 4-4: *Organizational Test – IRC 501(c)(3) CPE Article*
- Exhibit 4-5: *Rev. Proc. 82-2*, 1982-1 C.B. 367
- Exhibit 4-6: *Rev. Rul. 75-38*, 1975-1 C.B. 161
- Exhibit 4-7: *Rev. Proc. 92-85*, October 1, 1992

### Training Aids
- TA 4-1, *Objectives*

### Notes to Instructor
- Create a flip chart of the *Objectives* to display throughout the chapter, or create a transparency using TA 4-1.
Chapter 4
Objectives

After completing this chapter you will be able to:

- Identify the types of entities that may qualify for exemption
- Determine whether an organizing document meets form requirements
- Describe the purposes specified in IRC section 501(c)(3)
• Determine whether an organizing document meets language requirements

• Explain how to correct deficiencies in the organizing document

• Identify the effective date of exemption based on the organizing document
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Chapter 4

Introduction to IRC Section 501(c)(3) and The Organizational Test

Overview

Introduction

To be exempt as an organization described in IRC section 501(c)(3), an organization must be both organized and operated exclusively for one or more purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Instructor Notes

Display and discuss the Objectives, or a review, on the flip chart.

Objectives

After completing this chapter you will be able to:

- Identify the types of entities that may qualify for exemption
- Determine whether an organizing document meets form requirements
- Describe the purposes specified in IRC section 501(c)(3)
- Determine whether an organizing document meets language requirements
- Explain how to correct deficiencies in the organizing document
- Identify the effective date of exemption based on the organizing document

Continued on next page
This chapter contains the following topics:

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<th>See Page</th>
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</thead>
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<td>39</td>
</tr>
<tr>
<td>Exhibit 4-5: Rev. Proc. 82-2, 1982-1 C.B. 367</td>
<td>55</td>
</tr>
<tr>
<td>Exhibit 4-6: Rev. Rul. 75-38, 1975-1 C.B. 161</td>
<td>61</td>
</tr>
<tr>
<td>Exhibit 4-7: Rev. Proc. 92-85, October 1, 1992</td>
<td>67</td>
</tr>
</tbody>
</table>
Organizing Document

Exhibit 4-1: Rev. Proc. 68-14

Explain that in order to apply for exemption, the applicant must be a legal entity and that the organizing document is made a permanent part of the administrative record.

Organizing Document Requirements

The organizational test relates to an organization’s organizing document. This test can only be met on the basis of the organization’s organizing document.

An organizing document must meet requirements in both form and language.

Defects in the organizing documents cannot be corrected by the organization’s actual operations or by reference to other documents (including Form 1023 or other statements).

All organizations are required to submit a conformed copy of their organizing document with their Form 1023 application.

(See Exhibit 4-1, Rev. Proc. 68-14)

Entity Types

An exempt organization may be:

- a corporation (IRC section 501(c)(3))
- an unincorporated association (IRC section 7701(a)(3)) or
- a trust (Fifth-Third Union Trust Co. v. Commissioner, 56 F.2d 767 (6th Cir. 1932))

An individual, a partnership, or a formless aggregation of individuals cannot be exempt. If no legal entity exists, the applicant will be advised that no ruling or determination letter will be issued.
Organizing Document - Corporations

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Refer students to the States document on the NERD Drive; explain how to use it.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form 1023, Part II, Item 1</td>
<td></td>
</tr>
</tbody>
</table>

Corporations

The organizing document for a corporation is known as articles of incorporation. Articles of incorporation are filed and approved by a variety of state officials. The states decide who is responsible for corporations in their state. For example, in Kentucky, articles of incorporation are filed with the Secretary of State.

Form Requirements - Certificates and Stamps

Articles of incorporation and any amendments that the organization submits must be a copy of what was filed with the state. The document must be signed by the incorporator and show evidence that they have been filed with and approved by the state in which the organization is incorporated. Generally, evidence of filing would include a Certificate of Incorporation or a “Filed” stamp on the articles of incorporation.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Stress that for-profit corporations are formed for the benefit of the incorporators and that stock can result in the inurement and private benefit which are precluded under section 501(c)(3).</th>
</tr>
</thead>
</table>

Non-Profit and Non-Stock

If non-profit statutes exist in a state, an organization seeking exemption under section 501(c)(3) of the Code must be incorporated under those statutes. Note that some states, however, do not have separate laws to govern non-profit and for profit corporations.

The articles of incorporation cannot make provisions for the issuance of stock to shareholders that would take ownership in the corporation and share in the earnings. The one exception is that if the articles provide that all stock will be held by organizations described in IRC section 501(c)(3) and cannot be transferred to a non-501(c)(3) organization.
Organizing Document – Associations

The organizing document for an association may be one of the following:

- Articles of organization (This includes limited liability corporations (LLC) whose members are 501(c)(3) organizations.)
- Articles of association
- Constitution
- Bylaws
- Code of regulations

Exhibit 4-2: Declaration

Explain that if bylaws only contain operating guidelines they generally do not constitute an organizing document.

At a minimum, the document must include the following:

- Name of the organization
- Purpose of the organization
- Date of adoption and
- Signatures of at least two individuals

If a signed copy of the association’s original organizing document cannot be produced, the organization may attach a declaration to the unsigned document attesting to its authenticity.

(See Exhibit 4-2, Declaration)
Organizing Document – Associations, Continued

Instructor Notes

Explain that Grade 11 specialists should not see true LLCs – reserved higher graded inventory.

Organizational Test – LLC Formed in Error

Generally, if an LLC lists private shareholders or individuals as members in its articles of organization (or similar organizing document), it was formed in error.

LLCs that have formed in error should reform as a corporation, unincorporated association, or trust. This may involve the LLC either dissolving and creating a new organization or simply having the existing entity amend its legal form. The case can then be developed and worked under standard procedures.

If the organization refuses to reform or the organizing document lists an exempt organization as a member, discuss the issue with your manager for the next course of action.

Administrative Items

EIN considerations for changes in organizational structure:

- If the state of formation allows an LLC to amend its existing form to a corporation, the organization may continue to use its current EIN.
- If the organization must dissolve and create an entirely new organization, the organization must apply for a new EIN.
- If a new EIN is required, the EDS file should be corrected to reflect the new EIN.

Effective Date of Exemption

If an LLC changes its form to a corporation, association or trust, the effective date of exemption is the date of transformation or formation of the new entity.

Not Mandatory Review

Only applications involving true limited liability companies are subject to mandatory review by Quality Assurance per IRM 7.20.5.4(3)n.

Mandatory review is not required if an organization has changed its form to a corporation, association or trust.
Organizing Document – Trusts

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain what each type of trust is.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Explain that testamentary trusts are not the entire will, but merely the portion of the trust that provides for 501(c)(3) purposes.</td>
</tr>
<tr>
<td></td>
<td>Highlight Form 1023, Part II, Lines 4a and 4b.</td>
</tr>
<tr>
<td></td>
<td>Explain the terms “irrevocable” and “revocable”.</td>
</tr>
<tr>
<td></td>
<td>IRM 7.25.3.2.2</td>
</tr>
</tbody>
</table>

Trusts

A trust is a three-party arrangement in which the founder of the trust (commonly known as the donor, grantor, or settler) transfers legal title of the trust property to a trustee (a fiduciary with respect to the property) to hold and to manage for a third party (the trust’s beneficiary) in accordance with the intent of the grantor. The beneficiary holds beneficial title to the property.

The two common types of trusts submitted by organizations seeking exemption are:

Testamentary Trusts

A trust created by a will that takes effect at the grantor’s death.

*Inter Vivos* Trusts

A trust created during the lifetime of the grantor. The trust must be irrevocable.

The trust document must be executed by the grantor.

*Continued on next page*
### Trust Terms

The following are some terms commonly used when discussing trusts:

- **Grantor (also known as the trustor, settler, or founder)** – The individual or entity which transfers the trust property to the trustee.

- **Trust property (also referred to as the corpus, principal, estate or trust res)** – Trust property includes assets such as cash, investments and life insurance policies. The assets can either be transferred during life (*inter vivos*) or at death (testamentary). A trust must have some assets, even if it is only one dollar. A trust is “funded” with trust property.

- **Trustee** – The trustee is the individual or entity responsible for holding and managing the trust property for the benefit of the beneficiary. Trustees can be a corporate fiduciary or any competent individual who is not a minor. The trustee holds the legal title to the trust property. As such, the trustee has a fiduciary duty to the beneficiaries with respect to the trust property. In the event of a breach of fiduciary duty, a trustee may be held personally liable. Such breaches include failing to pay out distributions or misappropriation.

- **Beneficiary** – The individual or entity that will receive the benefits of a trust property is called the beneficiary. The beneficiary holds the beneficial title to the trust property. It is important that the trust document clearly identifies the beneficiary or beneficiaries.

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Continued on next page
Explain classification as “private foundations” is discussed in Chapter 13A.

Many Trusts Are Private Foundations

A trust seeking tax-exempt status under IRC section 501(c)(3) will submit a Form 1023 to the Service. A trust that seeks exemption under IRC section 501(c)(3) and fails to meet the public charity requirements of IRC sections 509(a)(1), (2), or (3) will be classified a private foundation.

The following is a brief summary of trusts that may qualify for exemption as a tax-exempt private foundation (PF) under IRC section 501(c)(3). A more detailed description of private foundations will be discussed later.

A testamentary trust created by a will and funded with transferred assets to be used exclusively for charitable purposes will generally qualify as a private foundation.

A trust created by the transfer of assets to be used exclusively for charitable purposes will generally qualify as a private foundation.

A favorable determination letter may be issued to a trust recognizing it as a tax-exempt private foundation under IRC section 501(c)(3) and 509(a). Tax-exempt private foundations are:

- subject to all of the provisions of Chapter 42 of the Code and
- required to annually file a Form 990-PF with the Service

Continued on next page
Some trusts are classified as non-exempt charitable trusts or split-interest trusts. These types of trusts do not qualify for recognition of exemption under IRC section 501(c)(3); however, they are presumed to be and treated as private foundations.

**Instructor Notes**
- Explain what an NECT is and treatment as a PFC.
- Have students access IRC 4947(a) in the Code.
- Exhibit 4-3: Rev. Proc. 72-50.

An *inter vivos* trust with assets dedicated “exclusively” for charitable purposes that has not submitted a Form 1023 to the Service requesting exemption under IRC section 501(c)(3) and a ruling on foundation status may be treated as a **non-exempt charitable trust** under the provisions of IRC section 4947(a)(1). These organizations may be treated as private foundations or seek a determination for classification as supporting organizations under IRC section 509(a)(3).

(See Exhibit 4-3, Rev. Proc. 72-50)

**Non-Exempt Charitable Trust**

An irrevocable trust with assets dedicated “exclusively” to charitable purposes would be considered exempt under IRC section 4947(a)(1) and a trust with assets dedicated to both charitable and non-charitable beneficiaries would be recognized as exempt under the provisions of IRC section 4947(a)(2). Neither trust would be required to file a Form 1023 with the Service to be recognized as tax exempt under the above Code sections.

**Instructor Notes**
- Explain what a split-interest trust is.

**Split-Interest Trust**

An *inter vivos* trust which provides for payments to a non-charitable beneficiary as well as payments to a charitable interest and has not submitted a Form 1023 to the Service requesting exemption under IRC section 501(c)(3) and a ruling on foundation status is considered to be a **split-interest trust** described in IRC section 4947(a)(2).
**Organizing Document – Deficiencies and Language**

**Instructor Notes**

Stress that only the purpose and dissolution are required.

---

**Deficiencies in Form and Correction**

When an organizing document does not meet the form requirements, use the table below to determine actions needed to correct the deficiency:

<table>
<thead>
<tr>
<th>Organization</th>
<th>Situation</th>
<th>Correction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporation</td>
<td>Formed under state’s for-profit or business corporation law</td>
<td>Need to reincorporate under state’s nonprofit corporation law</td>
</tr>
<tr>
<td></td>
<td>Formed under state’s nonprofit corporation law on a stock basis where a</td>
<td>either:</td>
</tr>
<tr>
<td></td>
<td>stockholder (even if it is exempt under IRC section 501(c)(3)) may</td>
<td>Reorganize as a non-stock corporation</td>
</tr>
<tr>
<td></td>
<td>transfer stock and is entitled to share in the organization’s earnings</td>
<td>or:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Amend articles to restrict transfer of stock and prohibit payment of</td>
</tr>
<tr>
<td></td>
<td></td>
<td>dividends</td>
</tr>
<tr>
<td>Association</td>
<td>Document does not show evidence that the original was signed</td>
<td>Need a completed “Declaration” signed by two current officers that it is</td>
</tr>
<tr>
<td></td>
<td></td>
<td>a true copy of the original and that the organization has been operating</td>
</tr>
<tr>
<td></td>
<td></td>
<td>in accordance with the terms of the document.</td>
</tr>
</tbody>
</table>

There are usually no problems in the form of *inter vivos* and testamentary trusts. The major issue with trusts involves determining that there are actual assets held in trust (the date on which the trust was funded).

*Continued on next page*
Instructor Notes

Mention: An organization recognized (meaning an organization which received a determination or ruling letter) as exempt under IRC 501(c)(3) prior to July 27, 1959 is not required to meet the organizational requirements of IRC 501(c)(3) unless it seeks a new determination of its status. Nor will its exemption be revoked solely for failure to meet these requirements. Treas. Reg. 1.501(c)(3)-1(b)(6)

IRM 7.25.3.3

Reference Pub 557 – Sample Articles of Organization

Exhibit 4-4: 2004 CPE article

Required Clauses

The organizing document must:

- Include an acceptable purpose clause (Treas. Reg. 1.501(c)(3)-1(b)(1)(i)(a))
- Include a dissolution clause in most cases (Treas. Reg. 1.501(c)(3)-1(b)(4))

Reference in the bylaws is not acceptable for either of the above clauses unless the bylaws are the governing document for an unincorporated association.

- Not include a powers clause which is too broad (Treas. Reg. 1.501(c)(3)-1(b)(1)(i)(b))

(See Exhibit 4-4, FY 2004 CPE article)
## Purpose Clause

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>IRM 7.25.3.3.1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Have students look up 501(c)(3) in the Code.</td>
</tr>
<tr>
<td></td>
<td>Highlight Form 1023, Part III, Line 1.</td>
</tr>
</tbody>
</table>

### Introduction

IRC section 501(c)(3) provides exemption to organizations which are organized and operated for the following purposes:

- Charitable
- Religious
- Scientific
- Testing for Public Safety
- Literary
- Educational
- Fostering national or international sports competitions
- Prevention of cruelty to children or animals

*Continued on next page*
Purpose Clause, Continued

Instructor Notes
Go through examples listed in the text.

Purpose Clause
The purpose clause is acceptable if it limits the organization’s purpose to exclusively one or more purposes specified in IRC section 501(c)(3). The purpose clause may be narrower or more specific than the purposes specified in IRC 501(c)(3), but it may not be broader.

Example:
An organization with the purpose of teaching lacrosse to youths, aged 17 and under.
Teaching a sport to children is charitable because it develops their character and prevents juvenile delinquency; therefore, it meets the organizational test.

Example:
An organization with the purpose of providing housing to residents of Evans County.
This purpose clause does not meet the organizational test because providing housing may or may not be conducted for a charitable purpose.

Example:
An organization is organized to better mankind in all ways that are allowed and appropriate under the law.
This purpose clause is too broad because bettering mankind may be achieved in many ways, not all of which are within IRC section 501(c)(3).

Continued on next page
Purpose Clause,  Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that this is merely recommended language and that we evaluate what is in the organizing documents to determine whether it meets the minimum requirements of the law.</th>
</tr>
</thead>
</table>

Sample Purpose Clause

The following purpose clause may be used:

Said organization is organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future Federal tax code.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Stress that this language may be recommended if the activities of the organization call for it. However, the language is not required and organization would generally not be requested to amend to include it if the powers provision is good.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Have students review IRM 7.25.3.12.1.4</td>
</tr>
</tbody>
</table>

Powers Clause

An organizing document that expressly empowers the organization to engage in activities which are not in furtherance of one or more exempt purposes (other than as an insubstantial part of its activities) will not meet the organizational test.

Example:

Said organization may (or will) operate a manufacturing business, social club, influence legislation, or intervene in political campaigns, etc.

Any one of the above activities in the organizing document will cause the organization to fail the organizational test.

Continued on next page
Instructor Notes

Explain that deficiencies in language may be corrected by amendment to the organizing document.

Deficiencies in Language and Correction

As is with defects in the form of an organizing document, deficiencies in the language of an organizing document must be corrected.

<table>
<thead>
<tr>
<th>If</th>
<th>Then:</th>
</tr>
</thead>
</table>
| The purpose clause:  
  - is missing  
  - is too broad  
  - includes non-exempt purposes | Articles must be amended to:  
  - include  
  - be more specific  
  - delete |
| An overly broad powers clause is present | Articles must be amended to delete or prohibit |

Note: Amendments to a testamentary trust must be filed with, and approved by, the appropriate authority. For example, the Probate Court is the appropriate authority in some jurisdictions.
Dissolution Clause

Instructor Notes

Highlight Form 1023, Part III, Lines 2a, 2b, and 2c.
IRM 7.25.3.3.6

Dedication of Assets

An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose.

An organization’s assets are permanently dedicated to an exempt purpose if, upon dissolution, its net assets would be distributed:

- For exempt purposes within the meaning of IRC section 501(c)(3)
- To the federal government, state, or local government for a public purpose
- By a court to another organization to be used in a manner that the court believes would best accomplish the purposes of the dissolved organization

Continued on next page
Dissolution Clause, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Exhibit 4-5: Rev. Proc. 82-2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain that as state laws have changed that this document has become outdated, but is generally still accurate. Specialists should cross reference to the State document for current treatment.</td>
<td></td>
</tr>
<tr>
<td>IRM 7.25.3.3.6.4</td>
<td></td>
</tr>
</tbody>
</table>

**Applicability of State Law of Assets**

Where an organizing document does not have an express dissolution clause, laws of some states provide for the distribution of charitable assets upon dissolution. These states are known as “*cy pres*” states.

Organizations incorporated in *cy pres* states need not have an express dissolution clause in their organizing document. However, if the dissolution clause in an organizing document or if state law does not meet the “dedication of assets” requirement, the organization does not meet the organizational test.

*(See Exhibit 4-5, Rev. Proc. 82-2)*

**Cy Pres**

The term *cy pres* comes from French law and means “so near” or “as near as possible.” It is based on the legal doctrine that where the maker of a charitable trust had a **general charitable intent**, a court has the power to revise the trust to meet unexpected emergencies that threaten the trust’s existence.

The courts in *cy pres* states will apply the *cy pres* doctrine to testamentary charitable trusts, substituting other beneficiaries which closely approach the original charitable purpose.

*Continued on next page*
Dissolution Clause, Continued, Continued

Example of General Charitable Intent vs. Specific Intent

The following example demonstrates how a state court might apply the *cy pres* doctrine to a factual situation:

X bequeathed his residuary estate to Hospital A for the benefit of tubercular children. When X died, Hospital A no longer existed and X’s heirs filed suit claiming that the legacy lapsed and that the residuary estate should pass to them by intestacy.

The court held that the gift to Hospital A was a charitable bequest because the gift was not intended for a particular institution, but for the benefit of tubercular children as a class with the hospital as trustee.

Though Hospital A did not exist, the purpose for which the trust was created (treatment of tubercular children) still existed. Therefore, the legacy did not lapse because the *cy pres* doctrine applied. The court awarded the legacy to another local hospital as trustee for the benefit of tubercular children.

Instructor Notes

Stress that this is sample language.

Describe example of a named beneficiary. Explain how correction would be made.

Sample Dissolution Clause

For an organization that needs an express dissolution clause, the following language may be used:

Upon the dissolution of [this organization], assets will be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future Federal tax code, or shall be distributed to the Federal government, or to a state or local government, for a public purpose.

Instructor Notes

Stress that this is mandated by the State. Reference the States document.

When is a Dissolution Clause Required?

Use the table on the next page to determine whether an organization must include an express dissolution clause in its governing instrument.

Continued on next page
<table>
<thead>
<tr>
<th>Type of Organization</th>
<th>States</th>
<th>Clause Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unincorporated association</td>
<td>All</td>
<td>Yes</td>
</tr>
<tr>
<td>Corporation</td>
<td>Arkansas, California, Louisiana, Massachusetts, Minnesota, Missouri, Ohio, Oklahoma, Tennessee, Texas</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>All other 42 states and D.C.</td>
<td>Yes</td>
</tr>
<tr>
<td>Charitable Trust <em>Inter vivos</em></td>
<td>Delaware</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>All other 49 states and D.C.</td>
<td>Yes</td>
</tr>
<tr>
<td>Charitable Trust Testamentary, with specific intent</td>
<td>Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, Tennessee, Texas, Vermont, Washington, Wisconsin</td>
<td>Yes</td>
</tr>
<tr>
<td>Charitable Trust Testamentary, with general intent</td>
<td>same 32 states as above</td>
<td>No</td>
</tr>
<tr>
<td>Charitable Trust Testamentary, specific or general intent</td>
<td>Alabama, Delaware, Louisiana, Maine, Pennsylvania, South Dakota, Virginia, West Virginia*</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>*applies to private foundations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alaska, American Samoa, Arizona, Hawaii, Idaho, Montana, Nevada, New Mexico, North Dakota, South Carolina, Utah, Wyoming</td>
<td>Yes</td>
</tr>
</tbody>
</table>
## Private Foundation Language

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highlight Form 1023, Part X, Line 1b.</td>
</tr>
</tbody>
</table>

Exhibit 4-6: *Rev. Rul. 75-38*, 1975-1, C.B. 161. Advise that the law in Arizona changed since the Rev. Rul. was issued.

Stress that this only applies to private foundations.

### Additional Required Language of Private Foundations

Organizations described as private foundations must have additional language in their organizing documents in order to satisfy the organizational test under IRC section 508(e).

Other than New Mexico, all states have enacted statutory provisions that satisfy the requirements of IRC section 508(e).

In cases where an organization expressly provides in its governing instrument that the applicable sections of state law with respect to private foundations do not apply to it, an amendment is required to satisfy IRC section 508(e).

Organizations which appear to be private foundations in **New Mexico** must include in their organizing documents the following provisions:

- [This organization] must comply with the income distribution requirements of IRC section 4942 and
- [This organization] is prohibited from action in violation of IRC sections 4941, 4943, 4944, and 4945

The specific private foundation requirements and prohibitions may be listed in the organizing document with or without reference to the code section to meet the organizational test.

*(See Exhibit 4-6, Rev. Rul. 75-38)*
Effective Date of Exemption

Instructor Notes

Stress that the effective date of exemption is not arbitrary.

General Rule

In general, if an organization otherwise qualifies for exemption, the effective date of exemption is the date the organizing document was adopted and conformed.

Instructor Notes

Exhibit 4-7: Rev. Proc. 92-85

27 Month Filing Requirement

IRC section 508(a) requires that organizations seeking exemption under IRC section 501(c)(3) submit their application, Form 1023, within 15 months from the date of formation.

Section 4 of Rev. Proc. 92-85 provides an automatic 12-month extension to organizations applying under IRC section 501(c)(3).

Thus, organizations have 27 months from the date of their formation to submit their Form 1023 application.

(See Exhibit 4-7, Rev. Proc. 92-85)

Application Submitted Timely

If the Form 1023 application is submitted timely (within 27 months), the effective date of 501(c)(3) status is the date of legal formation. In the case of trusts, this is generally the date a trust is funded and not the signature date of the creator.

Continued on next page
Effective Date of Exemption, Continued

<table>
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<tr>
<th>Instructor Notes</th>
<th>Go through Schedule E of Form 1023.</th>
</tr>
</thead>
</table>

Application Submitted After 27 Months

Generally, the effective date of exemption for an applicant that submits the Form 1023 application beyond the 27 month requirement is the postmark date of the application. However, the organization may apply for relief from the timely filing requirement under the provisions of Treas. Reg. 301.9100-1. This is done on Schedule E of Form 1023.

| Instructor Notes | Explain how the $5,000 average is calculated.  
Refer students to 1.508-1(a)(3)(i). |
|------------------|-------------------------------------|

Exceptions for Late Filing

The following organizations are not subject to the provisions of IRC section 508(a):

- Churches
- Public charities whose annual gross receipts are normally $5000 or less
- Organizations formed on or before October 9, 1969
- Organizations that were subordinates in a group exemption that are submitting their application within 27 months from the date in which they were no longer included in the group

Continued on next page
Effective Date of Exemption, Continued

**Instructor Notes**

IRM 7.25.3.21.3.1

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**Exemption Under IRC Section 501(c)(4) for Prior Period**

When an organization does not meet any of the exceptions but otherwise qualifies for exemption under IRC section 501(c)(3), it may choose to accept exempt status under IRC section 501(c)(4) for the period prior to the postmark date of its application. (Rev. Rul. 80-108, 1980-1, C.B. 119)

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**Instructor Notes**

Explain how exemption is sometimes granted effective as of date non-exempt activities ceased.

---

**Exception**

In limited situations, the effective date of exemption under IRC section 501(c)(3) may be other than the date of formation or the postmark date.

If the organization has conducted activities that cause them to fail the operational test for exemption under IRC section 501(c)(3), exemption can be recognized from the date the organization verifies that the activities are no longer conducted. In this case, the organization must submit a written statement agreeing to a specified effective date.
## Deductibility of Contributions

<table>
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<tr>
<td>Discuss Pub 1771 – <em>Charitable Contributions-Substantiation and Disclosure Requirements.</em></td>
</tr>
<tr>
<td>Have students access IRC section 170 and Treas. Reg. 1.170.</td>
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### Introduction

IRC section 170(c)(2) provides that contributions by a donor to an organization described in IRC section 501(c)(3), except to those organizations that are testing for public safety, are tax-deductible to the donor.

IRC section 501(c)(3) organizations are supported by various sources of revenue. Only those contributions for which nothing is received in return are deductible.

### Preferred Status

Because organizations exempt under IRC section 501(c)(3) receive deductible contributions, it is a much sought after status by applicants.

Careful consideration must be given to the facts of a case and applicable tax law to ensure that both the organizational and the operational tests for exemption are met prior to recognizing exempt status under IRC section 501(c)(3).
Summary

To be exempt as an organization described in IRC section 501(c)(3), an organization must be both organized and operated exclusively for one or more purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

The organizational test can only be met on the basis of the organization’s organizing document. An organizing document must meet requirements in both form and language.

An exempt organization may be a corporation, unincorporated association or trust. Corporations file articles of incorporation with their state officials, associations. Unincorporated associations may use a variety of organizational document types such as articles of association, constitution or bylaws. An association’s organizing document must contain the name of the organization, purpose of the organization, date of adoption, and be signed by at least two individuals. A trust is a three-party arrangement in which the founder of the trust (commonly known as the donor, grantor, or settler) transfers legal title of the trust property to a trustee (a fiduciary with respect to the property) to hold and to manage for a third party (the trust’s beneficiary) in accordance with the intent of the grantor.

An organizing document must contain an acceptable purpose clause and a dissolution clause in most cases. Where an organizing document does not have an express dissolution clause, laws of some states provide for the distribution of charitable assets upon dissolution. These states are known as “cy pres” states.

In general, if an organization otherwise qualifies for exemption, the effective date of exemption is the date the organizing document was adopted and conformed. An organization must apply for exemption within 27 months of its formation date although there are exceptions to this requirement.

Contributions to organizations which qualify for exemption under IRC section 501(c)(3) are generally tax-deductible to the donor, making exemption under IRC section 501(c)(3) a very sought after status.
Summary Exercise 4-1

1. Identify two common types of trusts that are submitted as an organizing document.

   Answer: Testamentary and Inter vivos

2. Which of the following would not qualify as an IRC section 501(c)(3) organization?

   (a) corporation
   (b) partnership
   (c) unincorporated association
   (d) trust

   Answer: False. Partnerships, loose affiliated groups of individuals, and individuals cannot qualify for exemption under section 501(c)(3).

3. What is the legal doctrine that permits a court to revise the general charitable intent of a trust document to meet unexpected emergencies that threaten the trust’s existence?

   Answer: Cy pres. This doctrine permits the courts to substitute other beneficiaries which are believed to approach the original charitable purpose of the trust as closely as possible.

4. The language required to be included in the organizational document of organizations seeking exemption under IRC section 501(c)(3) as a public charity and those seeking exemption as a private foundation under IRC section 509(a) are the same.

   (a) True          (b) False

   Answer: False IRC section 508(e) requires the organizational language that the organization must comply with the income distribution requirements of IRC section 4942 and that the organization is prohibited from actions in violation of IRC sections 4941, 4943, 4944, and 4945. This language requirement is covered by state law except for private foundations organized in the state of New Mexico.

5. Organizations seeking exemption under IRC section 501(c)(3) must include two clauses in their organizing document. What are those clauses?

   Answer: 1. Purpose

   2. Dissolution

   Continued on next page
Summary Exercise 4-1, Continued

6. If an organization was incorporated on January 31, 2006 and submits its application on March 31, 2008, has the organization submitted the Form 1023 application timely?

**Answer:** Yes. The application was submitted within 27 months from date of formation.

7. Is the following dissolution provision acceptable? The organization was incorporated in California.

   “Upon dissolution, any remaining assets will be distributed to the United Way.”

**Answer:** No. Treas. Reg. 1.501(c)(3)-1(b)(4) provides that the assets must be dedicated to an exempt “purpose.” Since a named beneficiary at the time of dissolution may not be qualified, may not be in existence, or may be unwilling or unable to accept the assets of the dissolving organization, the Articles should be amended to provide for distribution of the assets for one or more of the purposes specified in IRC Section 501(c)(3).

**Note:** State statutes applicable to nonprofit charitable corporations in California will satisfy the provisions of section 1.501(c)(3)i(b)(4). So if the Articles in this instance had been silent on the dissolution provisions and contained a good purpose clause, the requirements of the organizational test would be met.

8. The Articles of Incorporation of an organization incorporated in North Carolina has a good purpose clause but does not have dissolution provisions. Does the organization need to file an Amendment to include an express dissolution clause?

**Answer:** Yes

9. An unincorporated association can be made up of one person.

   (a) True  (b) False

**Answer:** False

10. If an unincorporated association cannot produce a conformed copy of the original organizing document, they cannot meet the organizational test for exemption under section 501(c)(3).

   (a) True  (b) False

**Answer:** False. The organization can submit a declaration signed by two current authorized individuals stating that the document they are submitting is a true and correct copy of the original.
Summary Exercise 4-2

Will the following purposes meet the organizational requirements under IRC section 501(c)(3)? Why or why not?

a. Organization will operate a school

**Answer: No.** A school may be operated for purposes broader than those in 501(c)(3).

b. Exercise all rights and powers conferred by the state of Virginia upon non-profit corporations

**Answer: No.** The non-profit statutes in the state of Virginia pertain to all non-profit corporations, not just 501(c)(3) organizations.

c. To operate a home for the aged

**Answer: No.** A home for the aged may be operated in a manner broader than the purposes of 501(c)(3).

d. To be operated for charitable purposes

**Answer: Yes.** Charitable purposes are specifically named in IRC 501(c)(3).

e. Formed for exempt purposes under internal revenue code 501(c)(3)

**Answer: Yes.**

f. Organized to engage in research

**Answer: No.** Research may be conduct for purposes broader than 501(c)(3).

g. Formed for charitable, cultural and benevolent purposes

**Answer: No.** Cultural and benevolent purposes are not described in section 501(c)(3).

h. Make payments and distributions in furtherance of section 501(c) purposes

**Answer: No.** The purposes must be limited to section 501(c)(3).
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Revenue Procedure 68-14, 1968-1 CB 768

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 501; 1.501(a)-1.)

The Internal Revenue Service sets forth standards for acceptance of documents for purposes of section 501(a) of the Internal Revenue Code of 1954.

[Text]

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state what the Internal Revenue Service will accept as a "conformed copy" of a document within the meaning of section 1.501(a)-1(a)(3)(i) of the Income Tax Regulations.

SEC. 2. BACKGROUND.

Section 1.501(a)-1(a)(3)(i) of the regulations provides that an organization applying for exemption from Federal income tax under section 501 of the Internal Revenue Code of 1954 shall attach to its application a conformed copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the bylaws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

SEC. 3. STANDARDS.

.01 A conformed copy of a document is a copy that agrees with the document it purports to copy. For the purpose of the above-cited regulation, a copy of a document is a "conformed" copy if it contains all the provisions of the document as originally adopted and all amendments to it.

.02 A conformed copy may be handwritten, typed (original or carbon), printed, or produced by photographic or chemical processes.

.03 It is not necessary that the conformed copies be signed, but they must be accompanied by a declaration, signed by an officer authorized to sign for the organization, that they are complete and correct copies of the document they purport to copy. However, documents that are certified by an appropriate official of a state authority need not be accompanied by such declaration. A photographically or chemically reproduced copy of the certified document is also acceptable without the accompanying declaration if it clearly shows the certification.
.04 If the applicant is unable to secure a copy of any document as originally adopted (original articles of incorporation, declaration of trust, amendments, etc.), the Service will ordinarily accept a conformed copy of the document under which the organization is operating at the time of application. In such a case, the document must embody all the powers, principles, purposes, functions, and other provisions by which the organization currently governs itself. An authorized officer of the organization must affirm in writing the fact that the document (or documents) submitted does embody all such information.
DECLARATION

We declare that the ________________________________(organizing document) of _________________________________________________(insert name of organization)

was adopted by two or more members of our governing body on

___________________________________(insert exact date - mm/dd/yy).

The copy submitted with our application is a complete and accurate copy of our original document which was signed and dated by at least two of our officers.

_____________________________________
signature and title of officer/director or Power of Attorney

_____________________________________
date

_____________________________________
signature and title of officer/director or Power of Attorney

_____________________________________
date
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SECTION 1. PURPOSE AND SCOPE.

.01 The purpose of this Revenue Procedure is to provide procedures to be used by nonexempt charitable trusts described in section 4947(a)(1) of the Internal Revenue Code to obtain determinations of their foundation status under section 509(a)(3) of the Code. This Procedure is applicable to all section 4947(a)(1) trusts whether or not they are subject to the transitional rules of section 1.509(a)-4(i)(4) of the Income Tax Regulations (T.D. 7212, page 250).

.02 Charitable trusts that have received determination or ruling letters recognizing their exemption from tax under section 501(c)(3) of the Code are subject to section 508(b) of the Code. These trusts must file the notice required by section 508(b) in the manner provided in section 13.9 of the Temporary Regulations or they will be presumed to be private foundations. Filing a section 508(b) notice constitutes a request for a determination of private foundation status. Accordingly, this Procedure does not apply to such trusts. They may, however, refer to sections 3.02 and 3.03 below for guidance as to the information to be filed with section 508(b) notices where section 509(a)(3) of the Code is in question.

SEC. 2. BACKGROUND

.01 A trust described in section 4947(a)(1) of the Code is one that is not exempt from tax under section 501(a) of the Code, has all of its unexpired interests devoted to one or more of the purposes described in section 170(c)(2)(B) of the Code, and is a trust for which a charitable deduction was allowed. These trusts are subject to the private foundation provision (Part II of subchapter F of Chapter 1 and Chapter 42 of the Code) except sections 508(a), (b), and (c) of the Code.

.02 Almost all section 4947(a)(1) trusts that are not private foundations are supporting organizations within the meaning of section 509(a)(3) of the Code. Certain of these trusts meet the requirements of section 509(a)(3) of the Code under the transitional rules of section 1.509(a)-4(i)(4) of the regulations.

.03 While section 4947(a)(1) trusts are not subject to the section 508(b) presumption of private foundation status, they may, nonetheless, secure a determination of their status.
SEC. 3. PROCEDURE FOR REQUESTING DETERMINATIONS.

.01 A section 4947(a)(1) trust may request a determination of its status under section 509(a)(3) of the Code by filing a request with the District Director of Internal Revenue for the district where the trustee filing the trust's income tax return has his legal residence or principal place of business.

.02 A request for a determination based on the transitional rules of section 1.509(a)-4(i)(4) of the regulations should include the following information:

1. The name of the trust, its address, and Employer Identification Number;

2. A statement as to whether it has received any contributions since November 20, 1971;

3. The name, address, and Employer Identification Number of the beneficiary organizations together with a statement that each such beneficiary organization is described in section 509(a)(1) or (2) of the Code;

4. If a beneficiary organization is not designated in the trust instrument, a copy of the court order, or other evidence establishing that such organization possesses an equitable interest in the trust;

5. A list of all of the trustees that have served on or after November 20, 1970, together with a statement stating whether such trustees were disqualified persons within the meaning by section 4946(a) of the Code (other than as foundation managers);

6. A copy of the trust instrument in effect on November 20, 1970, and all amendments adopted thereafter; and

7. A statement indicating what provision has been made to provide the beneficiaries with the annual reports required by section 1.509(a)-4(i)(4) of the regulations.

.03 A request for determination that is not based on the transitional rules of section 1.509(a)-4(i)(4) of the regulations should contain the following information:

1. The name of the trust, its address, and Employer Identification Number;

2. The name, address, and Employer Identification Number of the beneficiary organizations together with a statement that each such beneficiary organization is described in section 509(a)(1) or (2) of the Code;
Exhibit 4-3 (Page 3 of 4)

3 A list of all of the trustees that have served on or after October 9, 1969, together with a statement stating whether such trustees were disqualified persons within the meaning of section 4946(a) of the Code (other than as foundation managers);

4 A copy of the trust instrument in effect on October 9, 1969, and all amendments adopted thereafter; and

5 Sufficient information to otherwise establish that the trust meets the requirements of section 509(a)(3) of the Code as provided for in section 1.509(a)-4 of the regulations (other than section 1.509(a)-4(i)(4)).

SEC. 4. PROCESSING REQUESTS FOR DETERMINATIONS

.01 District Directors of the exempt organizations key districts and the Director of International Operations are authorized to issue determination letters with respect to section 509 of the Code. Requests for determinations will be forwarded upon receipt to the appropriate key district or the Office of International Operations. A list of the key district offices and the area covered by each is set out in section 4.01 of Revenue Procedure 72-4, C.B. 1972-1, 706.

.02 When used in the remainder of this Revenue Procedure, the term "District Director" means the District Director of one of the 16 key district offices or the Director of International Operations.

.03 The District Director will issue determination letters where the issue is clearly covered by statute, Treasury Decision or regulation, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin.

.04 If, after reviewing a request for determination involving an issue described in section 4.03 above, the District Director concludes that an adverse decision is indicated, he will arrange a conference with representatives of the trust, if one has been requested before issuing an adverse determination letter. The trust is entitled to only one such conference as a matter of right.

.05 If a trust disagrees with a determination letter, it may ask the District Director to reconsider the matter. It may also ask the District Director to seek technical advice unless the determination letter was based on a technical advice memorandum. If the District Director in his discretion decides to seek technical advice, the procedures in Revenue Procedure 72-2, C.B. 1972-1, 695, will be followed.
.06 If a request for determination presents an issue that is not clearly covered by statute, Treasury Decision or regulation, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin, the District Director will seek technical advice under the procedures of Revenue Procedure 72-2 after advising the trust, as provided in section 4 of Revenue Procedure 72-2, and attempting to reach agreement on the facts and questions to be submitted. The District Director will issue the determination letter on the basis of the conclusions expressed in the technical advice memorandum, as provided in section 8.01 of Revenue Procedure 72-2. A copy of the technical memorandum will be furnished to the trust as provided in section 8 of Revenue Procedure 72-2.

SEC. 5. EFFECT OF A DETERMINATION LETTER

.01 Determination letters under section 509(a)(3) of the Code will be effective as of the date a trust is first deemed to meet the requirements of section 509(a)(3).

.02 A determination letter under section 509(a)(3) of the Code may not be relied upon if there is a material change in a trust's character that is inconsistent with the requirements of section 509(a)(3).

1 Also released as Technical Information Release 1206, dated October 17, 1972.
Overview

Purpose

“The difference between the right word and the almost right word is the difference between lightning and the lightning bug.” Mark Twain

This article addresses specific issues that have arisen in determining whether the organizational test is satisfied. The organizational test requires that the articles of organization (hereafter “creating document”) of an organization described in IRC 501(c)(3) contain an explicit statement that its purposes are 501(c)(3) exempt purposes. The organizational test also requires an appropriate dissolution provision unless operation of state law or court action produces the same result. Private foundations have additional organizational test requirements.

An organization’s creating document may be articles of incorporation, articles of association, trust indenture, or constitution. A limited liability company’s (LLC’s) creating document is its state-approved articles of organization. If an LLC has adopted an operating agreement then this document is part of the creating document, but it would not, separately, be required to meet the organizational test. The required provisions in the creating document or state law are important because they subject an organization to enforcement of these provisions by appropriate Federal, State, and judicial authorities. Most of the issues will be illustrated using a Question-and-Answer (Q & A) approach, along with numerous examples.

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Exempt Purposes and Dedication of Assets

An organization is organized exclusively for one or more 501(c)(3) exempt purposes only if its creating document:

- Limits the purposes of such organizations to one or more exempt purposes
- Does not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes, and
- Permanently dedicates the organization’s assets to 501(c)(3) purposes on dissolution

See Reg. 1.501(c)(3)-1(b)(1)(i) and 1.501(a)(3)-1(b)(1)(4)

The organizational test must be met by the creating document or state law. It cannot be met by oral representations or representations made in other documents. See Reg. 1.501(c)(3)-1(b)(1)(iv).

501(c)(3) Exempt Purposes

Exempt purposes are described in IRC 501(c)(3) and the applicable regulations. Exempt purposes described in IRC 501(c)(3) are:

- Charitable
- Religious
- Educational
- Scientific
- Literary
- Testing for public safety
- Fostering national or international amateur sports competition
- Preventing cruelty to children or animals

Exhibit 4-4 (Page 2 of 16)
Exempt Purposes and Dedication of Assets, Continued

Specific Charitable Purposes

The exempt purposes described in 501(c)(3) regulations encompass the general legal definition of the term “charitable.” The regulations list the following specific charitable purposes:

- Relief of the poor, the distressed, or the underprivileged;
- Advancement of religion
- Advancement of education or science
- Erecting or maintaining public buildings, monuments, or works
- Lessening the burdens of government
- Lessening neighborhood tensions
- Eliminating prejudice and discrimination
- Defending human and civil rights secured by law
- Combating community deterioration and juvenile delinquency

See Reg. 1.501(c)(3)-1(d)(2)

More 501(c)(3) Regulations Purposes

The 501(c)(3) regulations also include the exempt purpose of receiving contributions and paying them over to organizations that are described in IRC 501(c)(3). See Reg. 1.501(c)(3)-1(b)(1)(ii).

Finally, these regulations note the exempt purpose of operating of a school for education when the creating document describes in detail the manner of the operation of such school.

See Reg. 1.501(c)(3)-1(b)(1)(ii)

Publication 557

Publication 557, *Tax-Exempt Status for Your Organization*, (Rev. May 2003), at Chapter 3, *Articles of Organization*, contains samples of language that will meet the organizational test. However, other language may also satisfy the organizational test. For example, charitable purposes specified in revenue rulings and court decisions may be referenced. Publication 557 may be accessed at:

- (800) 829-3676 to order IRS tax forms and publications

Exhibit 4-4 (Page 3 of 16)
Q.1: Must an organization’s creating document contain a provision expressly limiting its purposes to one or more exempt purposes?

A1. Yes. The creating document must refer to purposes that come within those described in IRC 501(c)(3). This may be accomplished by a statement that it is formed for charitable, religious, educational, scientific, or other purposes referred to in IRC 501(c) (3) or the applicable regulations. The purposes do not have to expressly refer to IRC 501(c)(3).

See Reg. 1.501(c)(3)-1(b)(1)(ii)

Examples of Acceptable and Unacceptable Purposes

**Example**

If a creating document states that the organization is formed to operate for educational purposes, this statement would satisfy the purpose requirement since the term “educational” is contained in IRC 501(c)(3).

**Example**

If a creating document states that the organization is formed to eliminate prejudice and discrimination, this statement would satisfy the purpose requirement since the term “eliminate prejudice and discrimination” is contained in Reg. 1.501(c)(3)-1(d)(2).

**Example**

If a creating document states that the organization is formed to operate a school, this statement would not satisfy the purpose requirement. The term “school” is not contained in IRC 501(c)(3) or the applicable regulations. To operate a school does not necessarily further an exempt purpose. See Reg. 1.501(c)(3)-1(b)(1)(ii).

**Example**

If a creating document states that the organization is formed to operate a school for educational purposes, this statement would satisfy the purpose requirement.
Examples of Acceptable and Unacceptable Purposes, (continued)

**Example**

If a creating document states that an organization was formed to promote health, this statement would not satisfy the purpose requirement. To promote health does not necessarily further an exempt purpose. For example, a hospital might promote health by providing medical care without necessarily dedicating itself to the promotion of health in a charitable manner as described in Rev. Rul. 69-545, 1969-2 C.B. 117.

**Example**

If a creating document states that the organization was formed to operate a medical clinic to serve the health care needs of the community exclusively in furtherance of charitable purposes, this statement would satisfy the purpose requirement of the organizational test.

**Q2:** If a creating document contains a purpose that does not necessarily accomplish exempt purposes as described in IRC 501(c)(3), should the organization amend its creating document to limit its purpose to those described in IRC 501(c)(3)?

**A2.** Yes. However, if the creating document contains a purpose that does not satisfy the organizational test, but such purpose is not expressly contrary to 501(c)(3) exempt purposes, the following type of provision in the creating document will meet the purpose requirement of the organizational test:

“Notwithstanding other language (or provisions) in the creating document, the purposes will be limited exclusively to exempt purposes within the meaning of IRC 501(c)(3).” In this circumstance, no further amendment is necessary. This type of provision is generally referred to as a “notwithstanding clause.”

*See Reg. 1.501(c)(3)-1(b)(1)(iii)*
Exempt Purposes: Q & A’s and Examples, Continued

Examples of
the “Notwith-
standing
Clause”

Example: A creating document provides that an organization is formed to promote philanthropic and eleemosynary purposes. This statement would not satisfy the purpose requirement. But, if the creating document also states that notwithstanding any other provision in this instrument, it will not further any specified purpose to more than an insubstantial degree other than those described in IRC 501(c)(3), the organization would not have to amend its creating document to meet the purpose requirement of the organizational test.

Example: A creating document provides that an organization is formed to provide scholarship assistance to individuals. Without further limitation, the term “providing scholarship assistance to individuals” could describe purposes outside the scope of IRC 501(c)(3). For example, the term could include providing financial assistance to children who are pre-selected by the organization’s founder. Therefore, this statement would not satisfy the purpose requirement of the organizational test.

Example: A creating document provides that an organization is formed to provide scholarship assistance to individuals. It also provides that notwithstanding any other provision in this instrument, it will not further any specified purpose to more than an insubstantial degree other than those described in IRC 501(c)(3). This statement would satisfy the purpose requirement of the organizational test.

Example: A creating document provides that an organization is formed to promote educational and political purposes. Educational purposes come within the scope of the purposes described in IRC 501(c)(3); however, political purposes include intervening in political campaigns, which is specifically prohibited. Therefore, a notwithstanding clause would not be sufficient because the creating document contains a purpose that cannot be limited to make it fit within the scope of exempt purposes described in IRC 501(c)(3).
Q.3: Effect of Limitations on Activities  

**Q3.** If a creating document contains purposes outside of those described in IRC 501(c)(3) but expressly states that the organization will not engage in activities other than those described in IRC 501(c)(3), does this satisfy the purpose requirement?  

**A3.** No. A provision in an organization’s creating document limiting its activities to those described in IRC 501(c)(3) would not cure an overly broad purpose statement.  

---  

**Example:**  
A creating document states that an organization is formed to provide tutoring. The instrument also states that notwithstanding other language in the creating document, it will not engage in activities that are not described in IRC 501(c)(3). The provision of tutoring does not necessarily accomplish exempt purposes within the meaning of IRC 501(c)(3). If the notwithstanding clause had limited the organization’s purposes to those described in IRC 501(c)(3), rather than its activities, no amendment would be necessary. Limiting the organization’s activities does not correct its overly broad purposes statement.  

---  

Q.4 & 5: Cross-referencing IRC 170  

**Q4.** If a creating document contains a purpose clause that provides that the organization will limit its purposes to those carried out by organizations described in IRC 501(c)(3) or organizations contributions to which are deductible under IRC 170, should the organization amend its creating document to limit its purposes to those described in IRC 501(c)(3)?  

**A4.** Yes. IRC 170(c) refers to charitable contributions rather than charitable purposes. Under that section, contributions to organizations other than those described in IRC 501(c)(3) are treated as charitable contributions. For example, IRC 170(c)(5) refers to contributions to a cemetery company. Thus, a creating document stating that an organization’s purposes will be limited to those carried out by organizations described in IRC 170 would allow an organization to operate a cemetery.  

**Q5.** If a creating document refers to IRC 170(c)(1) or (c)(2) instead of IRC 170, should the organization amend its creating document to limit its purposes to those described in IRC 501(c)(3)?  

**A5.** No. IRC 170(c)(1) refers to contributions to a government entity exclusively for a public purpose and IRC 170(c)(2) refers to contributions for purposes that are consistent with those described in IRC 501(c)(3).
Exempt Purposes: Q & A’s and Examples, Continued

Q.6: Limitations on Prohibited Activities

Q6. Must an organization’s creating document include language that:

- Prohibits the inurement of net earnings to its members, trustees, officers, or other private persons
- Limits its activities to those described in IRC 501(c)(3)
- States that no substantial part of the activities of the organization shall be the carrying on of propaganda, or otherwise attempting to influence legislation; and/or,
- States that the organization will not participate in or intervene in a political campaign on behalf of or in opposition to a candidate for public office

A6. The Code and Regulations do not require any of these four specific provisions to be stated in a creating document. Thus, no amendment is necessary unless the creating document:

- Expressly states that there will be inurement of net earnings, such as a statement that the profits of the organization will be distributed to its members, officers, directors or other individuals;
- Describes activities that are outside the scope of IRC 501(c)(3) and does not indicate that such activities will be insubstantial;
- Expressly states that the organization will be engaged in the carrying on of propaganda, or otherwise attempting to influence legislation but does not indicate that the activities will be insubstantial or will come within the limits set forth in IRC 501(h); or,
- Expressly states that the organization participates in, or intervenes in, any political campaign on behalf of or in opposition to any candidate for public office.
Example

A creating document provides that an organization is formed for educational purposes. It also provides that the organization will be attempting to influence legislation. The creating document does not state that the legislative activities will be insubstantial. Therefore, the organization would need to specifically state that legislative activities will be insubstantial.

In this case, the organization would only need to add this restriction on influencing legislation and would otherwise not need to add any of the other limitations provisions listed in Q.6.

Q.7: Express Allowance of Prohibited Activities

Q7. If the organization has to amend its creating document for other reasons, can it be required to prohibit the activities described at Q.6?

A7. No. We may suggest that the organization consider adding language to that effect. However, we must also state that it is not required.

See Reg. 1.501(c)(3)-1(b)(3)
Q. 8: Effect of No Dissolution Provision and State Law Remedies

Q8. Must an organization’s creating document permanently dedicate its assets to an exempt purpose?

A8. Yes. An organization will not qualify for exemption unless its creating document contains a dissolution provision that permanently dedicates its assets to an exempt purpose. Publication 557, Tax-Exempt Status for Your Organization, (Rev. May 2003), at Chapter 3, Articles of Organization, contains samples of language that will meet the dissolution provision requirement.

However, an organization can also meet the dissolution provision requirement if, by operation of State law or court action, its assets would be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose, even though a specific dissolution provision is not contained in its creating document. See Reg. 1.501(c)(3)-1(b)(4).

For purposes of determining whether an organization will meet the dissolution provision requirement by operation of State law or court action Rev. Proc. 82-2, 1982-1 C.B. 367 provides that:

1. **Nonprofit charitable corporations** located in one of the states listed would not be required to include a dissolution provision in its creating document. This exception only applies to corporations. Any unincorporated nonprofit association needs an adequate dissolution provision in its organizing document.

2. **Charitable testamentary trusts** located in: a) one of the states listed would not be required to include a dissolution provision in its creating document, b) one of states listed would not be required to include a dissolution provision in its creating document if the settlor has demonstrated a general charitable intent in the language of the trust instrument, or c) one of the states listed in which the creating document always needs to include a dissolution provision.

3. An **inter vivos charitable trust**, except in Delaware, should be required to have an adequate dissolution provision in its creating document.
Q9. How does the organizational test apply to an organization whose creating document specifies that upon dissolution its assets will be distributed to a State or local government?

A9. An organization’s creating document must specify that its assets must be used for a public purpose if they are to be distributed upon dissolution to a State or local government. See Reg. 1.501(c)(3)-1(b)(4).

IRC 115(l) excepts from federal income tax amounts derived from the exercise of any essential governmental function and accruing to a State, any political subdivision thereof or the District of Columbia. Rev. Proc. 2003-12, 2003-4 I.R.B. 316 provides guidance on the dissolution provision for an organization described in IRC 501(c)(3) that requests a letter ruling that its income is excluded from gross income under IRC 115(l). This revenue procedure also provides examples of appropriate dissolution provisions. A copy of Rev. Proc. 2003-12 is Exhibit 1.

Q10. The language at Reg. 1.501(c)(3)-1(b)(4) provides that the assets of an organization described in IRC 501(c)(3) must be “dedicated to an exempt purpose.” In that section, it does not expressly refer to IRC 501(c)(3). Does this mean that a dissolution provision that refers to an exempt purpose without further limitation is sufficient?

A10. No. Reg. 1.501(c)(3)-1(a)(2) provides that for purposes of Reg. 1.501(c)(3)-1, the term “exempt purpose or purposes” means any purpose or purposes specified in IRC 501(c)(3). Accordingly, the reference to an exempt purpose at Reg. 1.501(c)(3)-1(b)(4) would include only those purposes described in IRC 501(c)(3). Thus, the creating document must expressly refer to IRC 501(c)(3) unless the language in the creating document indicates that the assets will be distributed:

For charitable purposes

For purposes identical to those of the organization, or

To a governmental entity exclusively for a public purpose. Where the assets will be distributed for purposes identical to those of the organization, a provision to that effect is sufficient. The organization need not repeat the language that appears in its purposes provision.
Q11. If the creating document indicates that the assets will be distributed to a particular organization that is described in IRC 501(c)(3), must it provide a contingency clause ensuring that the assets will be dedicated to a charitable purpose in the event the named organization is unwilling to accept its assets, is no longer described in IRC 501(c)(3), or is no longer in existence?

A11. Yes. Reg. 1.501(c)(3)-1(b)(4) requires that an adequate dissolution provision must specify that upon the dissolution of the organization its assets shall be distributed for one or more exempt purposes within the meaning of IRC 501(c)(3), or shall be distributed to the Federal government, or to a State or local government, for a public purpose. State law or court action of the type described in Rev. Proc. 82-2 satisfies the requirement for a dissolution provision where there is no provision in the creating document. However, if the creating document contains a dissolution provision that is defective, state law or court action would not cure the defect.
Private Foundations

Under IRC 508(e), a private foundation’s creating document must contain certain provisions concerning IRC 4941, 4942, 4943, 4944, and 4945. Publication 557, *Tax-Exempt Status for Your Organization*, (Rev. May 2003), at Chapter 3, *Private Foundations and Public Charities*, contains samples of language that will meet this private foundation requirement. However, other language may also satisfy this requirement.

Rev. Rul. 75-38, 1975-1 C.B. 161 identifies those states that have adopted legislation satisfying the requirements of IRC 508(e). Therefore, the governing instruments of private foundations located in those states are considered to satisfy the requirements of IRC 508(e) if additional specific requirements listed for each state are met.

Conclusion

The organizational test is a technical requirement that an organization must satisfy to be qualified for tax exempt status under IRC 501(c)(3). However, it should not be applied to compel an organization to add language to its creating document that is not required.

Exhibit 4- 4 (Page 13 of 16)
SECTION 1. PURPOSE

This Revenue Procedure provides guidance on dissolution provisions for any organization described in § 501(c)(3) and exempt from federal income tax under § 501(a) of the Code that requests a letter ruling that its income is excluded from gross income under § 115(1).

SECTION 2. BACKGROUND

.01 Section 115(1) of the Code provides that gross income does not include income that is (i) derived from a public utility or from the exercise of any essential governmental function (the "essential government function test"), and (ii) accruing to a State, any political subdivision thereof, or the District of Columbia (the "accrual test"). An entity is not required to obtain a ruling from the Service to claim an exclusion from gross income under § 115(1).

.02 One aspect of the accrual test of § 115(1) is that assets of the organization must be distributed upon the organization's dissolution to one or more States, political subdivisions thereof, the District of Columbia, or to other organizations the income of which is excluded from gross income under § 115(1) (the "distribution of assets upon dissolution requirement"). The assets of an entity described in § 115(1) may not be distributed upon dissolution (or at any other time) to the United States government. See Rev. Rul. 90-74, 1990-2 C.B. 34; Rev. Rul. 77-261, 1977-2 C.B. 45; Rev. Rul. 71-589, 1971-2 C.B. 94. An organization seeking a ruling under § 115(1) will not be found to satisfy the distribution of assets upon dissolution requirement of the § 115(1) accrual test if its articles of organization fail to limit distribution of all the organization's assets upon dissolution to one or more States, political subdivision(s) thereof, the District of Columbia, or to other organizations whose income is excluded from gross income under § 115(1).

.03 An organization may be described in § 501(c)(3) of the Internal Revenue Code and its income may also be excluded from gross income under § 115(1). See Treas. Regs. § 1.6033-2(g)(1)(v) (a state institution exempt from taxation under § 501(a) the income of which is excluded from gross income under § 115(a) (now § 115(1)) is not required to file an annual information return on Form 990, Return of Organization Exempt From Income Tax); see also Rev. Proc. 95-48, §§ 3.01, 4.02, 1995-2 C.B. 418.

.04 To qualify as an organization described in § 501(c)(3) and exempt from federal income tax under § 501(a), an organization must meet the requirements of the organizational test of § 501(c)(3). One requirement of the organizational test is that the assets of the organization be dedicated to an exempt purpose. Treas. Reg. § 1.501(c)(3)-1(b)(4).
.05 A § 501(c)(3) organization's articles of organization must contain a dissolution clause that satisfies the organizational test of § 1.501(c)(3)-1(b)(4) of the Treasury Regulations, unless the organization is organized under State laws that satisfy the distribution of assets upon dissolution provisions of § 1.501(c)(3)-1(b)(4). See Treas. Reg. § 1.501(c)(3)-1(b)(4); Rev. Proc. 82-2, 1982-1 C.B. 367.

SECTION 3. APPLICATION

A § 501(c)(3) organization can satisfy the organizational test of § 1.501(c)(3)-1(b)(4) of the Treasury Regulations by reason of its articles of organization or by operation of law. However, for purposes of obtaining a § 115(1) ruling, a § 501(c)(3) organization will not satisfy the "distribution of assets upon dissolution requirement" of § 115(1) unless its articles of organization also limit distribution of assets on dissolution (to the extent consistent with § 1.501(c)(3)-1(b)(4)) to one or more States, political subdivisions of States, the District of Columbia, or other organizations the income of which is excluded under § 115(1). For purposes of obtaining a § 115(1) ruling, the organization may not rely on a provision of state law to satisfy the distribution of assets upon dissolution requirement of § 115(1).

SECTION 4. EXAMPLES

.01 Organization A is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(3). Organization A has a dissolution clause in its articles of organization that satisfies Treas. Reg. § 1.501(c)(3)-1(b)(4). Organization A's articles state that, upon dissolution, any assets remaining after the payment of debts and the satisfaction of liabilities are to be distributed (1) to an organization described in § 501(c)(3) for one or more exempt purposes, or (2) to the United States government, or to a State or local government, for a public purpose. Organization A requests a letter ruling that its income is excluded from gross income under § 115(1). Although the dissolution clause in the articles of Organization A meets the organizational requirements of § 501(c)(3), the dissolution clause allows for distribution to entities to which distributions may not be made under § 115(1). The dissolution clause, therefore, fails to satisfy the distribution of assets upon dissolution requirement of the accrual test of § 115(1). In these circumstances, a favorable ruling on § 115(1) would not be issued.

.02 Organization B is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(3). Organization B has a dissolution clause in its articles of organization that satisfies Treas. Reg. § 1.501(c)(3)-1(b)(4). Organization B's articles state that, upon dissolution, any assets remaining after the payment of debts and the satisfaction of liabilities are to be distributed either (1) to a State or political subdivision thereof for a public purpose or (2) for one or more exempt purposes to an organization described in § 501(c)(3) and whose income is also excludable from gross income under § 115(1). Organization B requests a letter ruling that its income is excluded from gross income under § 115(1). The dissolution clause in the articles of Organization B meets the requirements of the organizational test of § 501(c)(3) and also satisfies the distribution of assets upon dissolution requirement of the accrual test of § 115(1).

Exhibit 4-4 (Page 15 of 16)
Organization C is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(3). Upon dissolution, Organization C's remaining assets will be distributed by operation of the law of Organization C's state of incorporation to a political subdivision of the state for a public purpose. Organization C requests a letter ruling that its income is excluded from gross income under § 115(1). Although state law provides a dissolution distribution scheme that meets the organizational test of Treas. Reg. § 1.501(c)(3)-1(b)(4), the state's dissolution provision fails to satisfy the accrual test of § 115(1) for purposes of obtaining a § 115(1) letter ruling. In these circumstances, a favorable ruling on § 115(1) would not be issued. To receive a favorable § 115(1) letter ruling, Organization C must have articles of organization that contain a provision satisfying the distribution of assets upon dissolution requirement for the § 115(1) accrual test. SECTION 5. DRAFTING INFORMATION The principal author of this revenue procedure is Sara T. S. Wolff of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue procedure, contact Ms. Wolff at (202) 622-
REV-PROC, Rulings and determination letters, Rev. Proc. 82-2, 1982-1 CB 367, (Jan. 01, 1982)

Rev. Proc. 82-2, 1982-1 CB 367

26 CFR 601.201: Rulings and determination letters.
(Also Section 501; 1.501(c)(3)-1.)

SECTION 1. PURPOSE

The purpose of this revenue procedure is to identify the states and circumstances in which the Service will not require an express provision for the distribution of assets upon dissolution in an exempt organization's articles of incorporation, trust instrument, or other organizing document to satisfy the "organizational" test in section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations. Also, this procedure provides a sample of an acceptable dissolution provision for organizations that are required to have an express provision for the distribution of assets upon dissolution.

SEC. 2. BACKGROUND

.01 Section 1.501(c)(3)-1(b)(4) of the regulations provides that:

(4) Distribution of assets on dissolution. An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders. [Emphasis added.]

.02 The issue of the applicability of state law in relation to section 1.501(c)(3)-1(b)(4) of the regulations as to a particular organization arises only where the organization itself has not provided for the distribution of its assets upon dissolution in its articles of incorporation, organizing document, or trust instrument. When state law satisfies the provisions of section 1.501(c)(3)-1(b)(4), it is not necessary to require an organization to amend its articles of incorporation or organizing document, or to require a trust to obtain a judicial decree amending its trust instrument, in order to satisfy the organizational test for qualification as an exempt organization described in section 501(c)(3) of the Code, where all the other requirements for exemption are met.
The issue of whether section 1.501(c)(3)-1(b)(4) of the regulations is satisfied under state law can be broken down into four areas according to the type of entity involved:

1. The cy pres doctrine as to inter vivos charitable trusts;
2. The cy pres doctrine as to testamentary charitable trusts, which can exist in a particular state by case law and/or by statute;
3. State corporate law containing statutes that provide for the distribution of assets upon the dissolution of nonprofit corporations; and
4. State law by court decision or statute relating to unincorporated associations.

Each of these four areas will be treated separately in this revenue procedure.

SEC. 3. GUIDELINES

.01 Inter Vivos Charitable Trusts.

1. Because there is no guarantee under the law of any jurisdiction, except Delaware, that cy pres would be used to keep an inter vivos charitable trust from failing, any inter vivos charitable trust, except in Delaware, should be required to have an adequate dissolution provision in its trust instrument to satisfy the requirements of section 1.501(c)(3)-1(b)(4) of the regulations.

.02 Testamentary Charitable Trusts.

1. The courts in the following states always apply the cy pres doctrine or the doctrine of equitable approximation to keep a charitable testamentary trust from failing, and thus section 1.501(c)(3)-1(b)(4) of the regulations with respect to charitable testamentary trusts is satisfied:

   Alabama
   Delaware
   Louisiana
   Pennsylvania
   South Dakota
   Virginia
   West Virginia (However, a state court decision has held that the cy pres doctrine does not apply to a scientific organization in West Virginia.)

2. The courts in the jurisdictions listed below will apply the cy pres doctrine to keep a charitable testamentary trust from failing when the language of the trust instrument demonstrates that the settlor had a general intent to benefit charity, and not merely a specific intent to benefit a
particular institution. In such jurisdiction the cy pres doctrine may be relied upon by a charitable testamentary trust to satisfy section 1.501(c)(3)-1(b)(4) of the regulations only when the settlor has demonstrated a general charitable intent in the language of the trust instrument. Unless the testator manifests a general intent to benefit charity, the Service will require the testamentary charitable trust to provide an express dissolution provision in the trust instrument to satisfy section 1.501(c)(3)-1(b)(4).

Arkansas
California
Colorado
Connecticut
District of Columbia
Florida
Georgia
Illinois
Indiana
Iowa
Kansas
Kentucky
Maine
Maryland
Massachusetts
Michigan
Minnesota
Mississippi

Missouri--MO. ANN. STAT. S352.210.3 satisfies the provisions of section 1.501(c)(3)-1(b)(4) of the regulations while MO. ANN. STAT. S355.230.(3) does not satisfy the requirements.

Nebraska
New Hampshire
New Jersey
New York
North Carolina
Ohio
Oklahoma
3 Charitable testamentary trusts in the following states need a dissolution provision in the trust instrument to satisfy section 1.501(c)(3)-1(b)(4) of the regulations because these states have either expressly rejected or have never applied the cy pres doctrine:

Alaska  
Arizona  
Hawaii  
Idaho  
Montana  
Nevada  
New Mexico  
North Dakota  
South Carolina  
Utah  
Wyoming  

.03 Nonprofit Charitable Corporations.

1 The statutes applicable to nonprofit charitable corporations in the states listed below will satisfy the provisions of section 1.501(c)(3)-1(b)(4) of the Regulations:

Arkansas  
California  
Louisiana  
Massachusetts  
Minnesota  
Missouri  
Ohio  
Oklahoma
All other states, and the District of Columbia do not have statutes applicable to nonprofit charitable corporations that will satisfy the provisions of section 1.501(c)(3)-1(b)(4). Thus, nonprofit corporations in the eight named states do not need a dissolution provision to satisfy section 1.501(c)(3)-1(b)(4). A nonprofit corporation in a jurisdiction not listed needs an adequate dissolution provision in its organizing document to satisfy section 1.501(c)(3)-1(b)(4).

.04 Unincorporated Nonprofit Associations.

None of the fifty-one jurisdictions provides certainty by statute or case law, for the distribution of assets upon the dissolution of an unincorporated nonprofit association. Therefore, any unincorporated nonprofit association needs an adequate dissolution provision in its organizing document to satisfy the requirements of section 1.501(c)(3)-1(b)(4) of the regulations.

.05 Sample Dissolution Provision.

1 For any organization that needs a dissolution provision in its organizing instrument to satisfy the provisions of section 1.501(c)(3)-1(b)(4) of the regulations, the following language is illustrative of what may be used:

(a) Upon the dissolution of [this organization], assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future Federal tax code, or shall be distributed to the Federal government, or to a state or local government, for a public purpose.

.06 Periodic Update.

This Revenue Procedure will be updated periodically as changes in state laws come to the attention of the Service.
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Section 508.--Special Rules With Respect to Section 501(c)(3) Organizations

26 CFR 1.508-3: Governing instruments.

[IRS Headnote] Private foundations; governing instruments; State laws enacted.-- States that have adopted legislation satisfying the requirements of section 508(e) of the Code, relating to private foundation governing instruments, are listed; Rev. Rul. 73-286 superseded.

[Text]

The purpose of this Revenue Ruling is to identify those States that have been held by the Internal Revenue Service to have adopted legislation satisfying the requirements of section 508(e) of the Internal Revenue Code of 1954, relating to private foundations.

Under section 508(e) of the Code, a private foundation (as defined in section 509) is not exempt from Federal income tax under section 501(a) unless its governing instrument contains certain provisions. These provisions, generally, must require or prohibit, as the case may be, the foundation to act or refrain from acting so that it will not be liable for the taxes imposed by sections 4941, 4942, 4943, 4944, and 4945.

Section 1.508-3(d) of the Income Tax Regulations provides that a private foundation's governing instrument is deemed to conform with the requirements of section 508(e) of the Code if valid provisions of State law have been enacted which:

(1) Require it to act or refrain from acting so as not to subject the foundation to the taxes imposed by sections 4941 (relating to taxes on self-dealing), 4942 (relating to taxes on failure to distribute income), 4943 (relating to taxes on excess business holdings), 4944 (relating to taxes on investments which jeopardize charitable purpose), and 4945 (relating to taxable expenditures), or

(2) Treat the required provisions as contained in the foundation's governing instrument.

The States listed below have enacted statutory provisions that satisfy the requirements of section 508(e) of the Code. Therefore, the governing instruments of private foundations under the jurisdiction of these States are generally considered to have been amended as required by section 508(e). However, provisions of these statutes vary widely. For this reason, the notations following the State listing are important.
ALABAMA--except where otherwise provided by a decree of a court of competent jurisdiction or by a provision in the private foundation's governing instrument which in either case has been entered or made after October 1, 1971, and expressly limits the applicability of State law.

ALASKA--except for such private foundations which expressly provide in their governing instruments that the applicable sections of Alaska law do not apply to them.

ARKANSAS--except for such private foundations which expressly provide in their governing instruments that the applicable sections of Arkansas law do not apply to them and except in the case of trusts where otherwise provided by decree of a court of competent jurisdiction.

CALIFORNIA--except where otherwise provided by a court of competent jurisdiction.

COLORADO--with respect to trusts that are private foundations except where otherwise provided by a court of competent jurisdiction.

CONNECTICUT--except where otherwise provided by a court of competent jurisdiction.

DELAWARE--except for such private foundations which expressly provide in their governing instruments that the applicable sections of Delaware law do not apply to them.

DISTRICT OF COLUMBIA--except for such corporations which expressly provide in their governing instruments that the applicable sections of District of Columbia law do not apply to them and except in the case of trusts where otherwise provided by a court of competent jurisdiction. (For purposes of this statute, corporations include corporations organized under any Act of Congress applicable to the District of Columbia as well as corporations organized under the laws of the District of Columbia.)

FLORIDA--except for such trusts which file a proper election not to be subject to the applicable provisions of Florida law and for such corporations as to which a court of competent jurisdiction has otherwise determined.

GEORGIA--except for such private foundations which file a proper election not to be subject to such law.

HAWAII--no exceptions.

IDAHO--except for such private foundations which expressly provide in their governing instruments that the applicable sections of Idaho law do not apply to them.

ILLINOIS--except for such corporations which have express provisions to the contrary in their articles of incorporation and except for trusts where it is otherwise provided by a court of competent jurisdiction.
INDIANA--except where otherwise determined by a court of competent jurisdiction with respect to private foundations organized before January 1, 1970.

IOWA--except for such private foundations which expressly provide in their governing instruments that the applicable sections of Iowa law do not apply to them.

KANSAS--except where otherwise provided by a court of competent jurisdiction.

KENTUCKY--except, with respect to corporations in existence on July 1, 1972, to the extent that such a corporation provides to the contrary by amendment to its articles of incorporation adopted after July 1, 1972, and, with respect to trusts in existence on July 1, 1972, where action is properly commenced on or before December 31, 1972, in a court of competent jurisdiction to excuse the trust from compliance with the requirements of section 508(e) of the Code.

LOUISIANA--except for such private foundations which expressly provide in their governing instruments that the applicable sections of Louisiana law do not apply to them.

MAINE--except where otherwise provided by a court of competent jurisdiction.

MARYLAND--except where otherwise provided by a court of competent jurisdiction.

MASSACHUSETTS--except where otherwise provided by a court of competent jurisdiction.

MICHIGAN--with respect to trusts that are private foundations except for such private foundations which file a notice of inconsistency under Michigan law.

MINNESOTA--except for private foundations that have been held by a court of competent jurisdiction not to be affected by such State statute.

MISSISSIPPI--except where otherwise provided by a court of competent jurisdiction.

MISSOURI--except for private foundations that have been held by a court of competent jurisdiction not to be affected by such State statute.

MONTANA--except in the case of trusts where otherwise provided by court decree entered after March 28, 1974, and except in the case of a corporation which has an express provision to the contrary in its articles of incorporation.
NEBRASKA—except for such trusts which effectively elect to be excluded from the applicable sections of Nebraska law, for such corporations which have governing instruments expressly providing to the contrary, and except as a court of competent jurisdiction has otherwise determined in any given case.

NEVADA—no exceptions.

NEW HAMPSHIRE—except where it is otherwise provided by a court of competent jurisdiction.

NEW JERSEY—except for such private foundations which expressly provide in their governing instruments that the applicable sections of New Jersey law do not apply to them.

NEW YORK—except where such law conflicts with any mandatory direction of an instrument by which assets were transferred prior to June 1, 1971, and such conflicting direction has not been removed legally.

NORTH CAROLINA—except for such private foundations which expressly provide in their governing instruments that the applicable sections of North Carolina law do not apply to them and except for trusts that have their governing instruments reformed by a decree of the Superior Court of North Carolina.

NORTH DAKOTA—with respect to trusts that are private foundations except where otherwise provided by a court of competent jurisdiction.

OHIO—except in the case of trusts where it is provided otherwise by a court of competent jurisdiction and except in the case of corporations in existence on September 17, 1971, which expressly adopt contrary provisions in their governing instruments after September 17, 1971.

OKLAHOMA—except for such private foundations which file a proper election not to be subject to such law.

OREGON—no exceptions.

PENNSYLVANIA—except where otherwise provided by a court of competent jurisdiction.

RHODE ISLAND—except where otherwise provided by a court of competent jurisdiction.

SOUTH CAROLINA—except for private foundations which expressly provide in their governing instruments that the applicable sections of South Carolina law do not apply to them.

SOUTH DAKOTA—except where otherwise provided by a court of competent jurisdiction.
TENNESSEE--except where otherwise provided by a court of competent jurisdiction.

TEXAS--except for such private foundations which file a proper election not to be subject to such law.

UTAH--with respect to trusts that are private foundations except where otherwise provided by a court of competent jurisdiction.

VERMONT--except where otherwise provided by a court of competent jurisdiction.

VIRGINIA--except for private foundations whose governing instruments contain express provisions to the contrary or which have filed a proper election not to be subject to such law.

WASHINGTON--except for such private foundations which expressly provide in their governing instruments that the applicable sections of Washington law do not apply to them.

WEST VIRGINIA--with respect to trusts that are private foundations except for such trusts which provide in their governing instruments that the applicable sections of West Virginia law do not apply to them.

WISCONSIN--except as may otherwise be provided by decree of a court of competent jurisdiction.

WYOMING--except where otherwise provided by a court of competent jurisdiction.

Returns: Extensions of time: Untimely elections.--The IRS has revised the standards used to determine whether it will grant an extension of time to make an election when the election's due date is fixed by regulation or certain other published guidance. Further, relief is granted for situations in which a statute states that an election must be made by the due date of a return or by the due date of the return including filing extensions that are authorized under Code Sec. 6081(a). Rev. Proc. 79-63 superseded. Rev. Proc. 87-32 and 92-20 modified. BACK REFERENCES: 92FED P13,803.084, 92FED P13,804.01, 92FED P13,807.25, 92FED P13,807.50, 92FED P20,307.013, 92FED P20,307.016, 92FED P20,307.093, 92FED P20,406.01, 92FED P20,406.025, 92FED P20,406.03, 92FED P20,406.045, 92FED P20,406.567, 92FED P20,406.60, 92FED P20,406.83, 92FED P20,613.025, 92FED P20,613.30, 92FED P22,240.043, 92FED P22,277.40, 92FED P25,465.0153, 92FED P25,465.026, 92FED P33,453.37, 92FED P33,462.20, 92FED P33,662.10, 92FED P37,789.0176, 92FED P44,384.40, 92FED P44,384.45 and 92FED P44,916.30.

SECTION 1. PURPOSE

This revenue procedure revises the standards the Commissioner of Internal Revenue Service will use to determine whether the Commissioner will grant an extension of time to make an election when the due date of the election is fixed by regulation or certain other published guidance pursuant to section 301.9100-1 of the Procedure and Administration Regulations. In addition, this revenue procedure provides relief for elections when a statute provides that the election must be made by the due date of the return or the due date of the return including extensions for filing the return that are authorized by section 6081(a) of the Internal Revenue Code.

The purpose of this revenue procedure is to provide relief to taxpayers who reasonably and in good faith fail to make a timely election when granting relief will not prejudice the interests of the government. This revenue procedure provides a means by which taxpayers can be in the same position they would have been in had they made their elections in a timely fashion.
SEC. 2. BACKGROUND

Section 301.9100-1 of the regulations sets forth rules regarding extensions of time for making elections or applications for relief. Upon good cause shown, the Commissioner has discretion to grant a reasonable extension of time fixed by a regulation, a revenue ruling, a revenue procedure, a notice, or an announcement published in the Internal Revenue Bulletin, for making an election or an application for relief in respect of tax under the Internal Revenue Code, except under subtitles E, G, H, and I, provided that granting the extension will not jeopardize the interests of the government.

Section 6081 of the Code provides that the Secretary may grant a reasonable extension of time for filing any return, declaration, statement or other document required by title 26 for a period of no more than 6 months (except when the taxpayer is abroad).

SEC. 3. SCOPE

.01 This revenue procedure applies to extensions of time for making certain elections or applications for relief when the deadline for the election or application is fixed by a regulation, a revenue ruling, a revenue procedure, a notice, or an announcement published in the Internal Revenue Bulletin, in accordance with section 301.9100-1(a) of the regulations. In addition, this revenue procedure applies to extensions of time when a statute provides that an election be made by the due date of the taxpayer's return or the due date of the taxpayer's return including extensions.

Furthermore, this revenue procedure applies to extensions for elections to use or requests to change an accounting method or an accounting period to the extent such elections are included in Appendix A, Appendix B, or have a due date prescribed by statute as the due date of the return or the due date of the return including extensions. Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in an adopted method of accounting, whether the change is from a permissible or impermissible method. See generally, Rev. Rul. 90-38, 1990-1 C.B. 57. The Commissioner's specific authorization and consent for retroactive adoption or change is given, however, with respect to the methods of accounting listed in the appendices to this revenue procedure.

Section 4 of this revenue procedure contains two automatic extensions: (1) an automatic 12-month extension for certain elections whose deadlines are prescribed by regulation or other administrative pronouncement, and (2) an automatic 6-month extension for elections when the Code provides that the election be made by the due date of the return or the due date of the return including extensions. Section 5 applies to elections (other than accounting method and period changes and elections) whose deadlines are prescribed by regulation or other administrative pronouncement if these elections do not qualify for relief under section 4. In addition, section 5 applies to elections described in Appendix B if these elections do not qualify for relief under section 4.

.02 This revenue procedure does not apply either to elections for which there is a special transitional rule in section 301.9100-1(b) of the regulations or to elections excepted from section 301.9100-1(a) by section 301.9100-1(c).
.03 For purposes of this revenue procedure, the term "taxpayer" has the same meaning as the term "person" defined in section 7701(a)(1) of the Code (rather than the meaning of the term taxpayer defined in section 7701(a)(14)).

SEC. 4. AUTOMATIC EXTENSIONS

.01 Automatic 12-month extension for certain elections whose deadlines are prescribed by regulation or other administrative pronouncement. An automatic 12-month extension is granted to make elections described in Appendix A (or in subsequent revenue procedures) provided the taxpayer takes corrective action within 12 months of the deadline for making the election. The extension runs from the original due date of the election.

Corrective action required for this automatic extension is (1) filing an original or an amended return to attach the appropriate form for making the election, or (2) for those elections not required to be filed with a return, taking the steps required to file the election in accordance with the regulation or other administrative pronouncement. Taxpayers who elect under this automatic extension (and all taxpayers whose tax liability would be affected by the election) must report their income (in the original or an amended return) in a manner that is consistent with the election for the year the election should have been made and for each subsequent year. The Service may invalidate an election if the taxpayer fails to report income consistent with the election in all affected years.

.02 Automatic 6-month extension for certain elections when the Code prescribes that the election be made by the due date of the return or the due date of the return including extensions. An automatic extension of 6 months from the due date of a return (excluding extensions) is granted to make elections whose due dates are prescribed by statute as the due date of the return or the due date of the return including extensions in the case of a taxpayer that timely files the return and takes corrective action within 6 months of the due date of the return (excluding extensions). This extension does not apply where the statute provides that the election be made by the due date of the return excluding extensions.

Corrective action required for this automatic extension is amending the filed return in the manner required to perfect the election. Taxpayers who elect under this automatic extension (and all taxpayers whose tax liability would be affected by the election) must report their income (in the original or an amended return) in a manner that is consistent with the election for the year the election should have been made and for each subsequent year. The Service may invalidate an election if the taxpayer fails to report income consistent with the election in all affected years.

.03 Procedural Requirements. Any return, statement of election, or other form of filing that must be made to obtain an automatic extension must provide the following statement at the top of the document: "FILED PURSUANT TO REV. PROC. 92-85". Any filing made pursuant to this section should be sent to the same address that the filing to make the election would have been sent had the filing been timely made. No request for a private letter ruling is required to obtain the extension. Accordingly, user fees do not apply to taxpayers taking corrective action under this section.

For situations outside of the scope of this section, see section 5.
SEC. 5. OTHER EXTENSIONS

Requests for extensions of time for elections (other than accounting method and period changes and elections) whose deadlines are prescribed by regulation or other administrative pronouncement that do not meet the requirements of section 4 above must be made under the rules of this section. In addition, this section applies to elections to use or requests to change an accounting method or accounting period that are listed in Appendix B (or in successor revenue procedures). Applications for relief that fall under this section will be granted when the taxpayer provides the evidence (including affidavits described in section 7) to establish that (1) the taxpayer acted reasonably and in good faith, and (2) granting relief would not prejudice the interests of the government.

.01 Reasonable Action and Good Faith.

(1) Subject to sections 5.01(4) and (5), when a taxpayer applies for relief under this section before the failure to make the election is discovered by the Service, the taxpayer will be deemed to have acted reasonably and in good faith.

(2) Subject to sections 5.01(4) and (5), a taxpayer that failed to make the election (which is discovered by the Service) will have acted reasonably and in good faith for purposes of this section if--

(a) the taxpayer inadvertently failed to make the election because of certain intervening events beyond the taxpayer's control or, because after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity of the election;

(b) the taxpayer reasonably relied on the written advice of the Service; or

(c) the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make or advise the taxpayer to make the election.

(3) For purposes of section 5.01(2), a taxpayer will not be considered to have reasonably relied upon a tax professional if--

(a) the taxpayer knew or should have known the tax professional was not competent to render advice on the election; or

(b) the taxpayer knew or should have known the tax professional was not aware of all relevant facts.

(4) A taxpayer will not be considered to have acted reasonably and in good faith for purposes of this section 5 if--

(a) the taxpayer seeks to alter a return position for which an accuracy-related penalty has been or could have been imposed under section 6662 of the Code and the new position requires or permits an election for which relief is requested; or
(b) the taxpayer was fully informed of the required election and related tax consequences and chose not to file the election.

(5) A taxpayer will not be considered to have acted reasonably and in good faith for purposes of this section 5 if the taxpayer uses hindsight in requesting relief. If specific facts have changed since the original due date of the election that make an election advantageous to a taxpayer, the Service will not ordinarily grant relief. In such a case, the Service will grant relief only when the taxpayer provides strong proof that the taxpayer's decision to seek relief did not involve hindsight.

.02 Prejudice to the Interests of the Government.

(1) The interests of the government are prejudiced if granting relief under this revenue procedure would result in a taxpayer having a lower tax liability in the aggregate for all years to which the election applies than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Similarly, if the tax consequences of more than one taxpayer are affected by the election, the government's interests are prejudiced if extending the time for making the election may result in the affected taxpayers, in the aggregate, having a lower tax liability than if the election had been timely made.

(2) Ordinarily, the Service will not grant relief when tax years that would have been affected by the election had it been timely made are closed by the statute of limitations. The Service may condition a grant of relief on the taxpayer providing the Service with a statement from an independent auditor (other than an auditor providing an affidavit pursuant to section 6.04) certifying that the requirements of section 5.02(1) are satisfied.

SEC. 6. PROCEDURAL REQUIREMENTS FOR REQUESTS UNDER SECTION 5

Requests for relief under section 5 of this revenue procedure must provide evidence which establishes the requirements set forth in sections 5.01 and 5.02 above, and must provide additional information as required by this section.

.01 The taxpayer must state when the applicable return, form, or document used to make the election or application for relief was required to be filed and when it was actually filed.

.02 The taxpayer must submit a copy of any documents relating to the taxpayer and referring to the election or application for relief.

.03 When requested, the taxpayer must submit a copy of the taxpayer's income tax return for the taxable year for which the taxpayer requests an extension or application for relief and any subsequent return affected by the election.

.04 When applicable, the taxpayer must submit a copy of the income tax returns of other taxpayers affected by the election.
.05 The taxpayer, or the individual who acts on behalf of the taxpayer with respect to tax matters, must submit a detailed affidavit describing the events that led to the failure to make a valid election or application for relief and to the discovery of the failure. When the taxpayer relied on a tax professional for advice, the taxpayer's affidavit must describe the engagement and responsibilities of the professional as well as the extent to which the taxpayer relied on the professional.

The affidavit must be accompanied by a dated declaration, signed by the taxpayer, which states: "Under penalties of perjury, I declare that, to the best of my knowledge and belief, the facts presented herein are true, correct, and complete." The individual who signs for a corporation must be an officer of the corporation and have personal knowledge of the facts and circumstances at issue. The individual who signs for a partnership must be a general partner with personal knowledge of the facts and circumstances at issue.

.06 The taxpayer must submit a detailed affidavit from the individuals having knowledge or information about the events that led to the failure to make a valid election or application for relief and to the discovery of the failure. These individuals must include:

(1) the taxpayer's income tax return preparer and any other individual (including an employee of the taxpayer) who made a substantial contribution to the preparation of the return; and

(2) any other accountant or attorney, knowledgeable in tax matters, who advised the taxpayer with regard to the election.

Any affidavit from such a tax professional must describe the engagement and responsibilities of the professional as well as the advice that the professional provided to the taxpayer.

Each such affidavit must include the name, current address, and taxpayer identification number of the affiant, and be accompanied by a dated declaration, signed by the affiant, which states: "Under penalties of perjury, I declare that, to the best of my knowledge and belief, the facts presented herein are true, correct, and complete."

.07 Requests for relief under this revenue procedure that are under the jurisdiction of the Associate Chief Counsel (Domestic) or the Associate Chief Counsel (Employee Benefits and Exempt Organizations) should be submitted in accordance with Rev. Proc. 92-1, 1992-1 I.R.B. 9, or its successors. Requests should be sent to either the Associate Chief Counsel (Domestic) or the Associate Chief Counsel (Employee Benefits and Exempt Organizations), Internal Revenue Service, Attention CC:CORP:T, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.

.08 Requests for relief under this revenue procedure that are under the jurisdiction of the Associate Chief Counsel (International) should be submitted in accordance with Rev. Proc. 92-7, 1992-1 I.R.B. 135, or its successors. Requests should be sent to Associate Chief Counsel (International), Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington D.C. 20044.
.09 Requests for relief under this revenue procedure that are under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations) should be submitted in accordance with Rev. Proc. 92-4, 1992-1 I.R.B. 66, or its successors, or if made in connection with an application for exemption from federal income tax, in accordance with Form 1023, Application for Recognition of Exemption. In the case of employee plans rulings, requests should be sent to Employee Plans Rulings, Internal Revenue Service, Assistant Commissioner (EP/EO), Attention E:EP:R, P.O. Box 14073, Ben Franklin Station, Washington, D.C. 20044. In the case of exempt organizations rulings, requests should be sent to Exempt Organizations Rulings, Internal Revenue Service, Assistant Commissioner (EP/EO), Attention E:EO, P.O. Box 120, Ben Franklin Station, Washington, D.C. 20044.

.10 Requests for relief submitted under section 6 must be accompanied by the applicable user fee.

SEC. 7. EXAMPLES

.01 Taxpayer error. Taxpayer prepares Taxpayer's own 1992 return. Taxpayer is unaware that an election subject to this revenue procedure is necessary in order for Taxpayer to report Taxpayer's income on the 1992 return in a particular manner. Nevertheless, Taxpayer reports this income in a manner that is consistent with having made this election. In 1995, Taxpayer hires an accountant to prepare Taxpayer's 1994 return. The accountant discovers that the election for 1992 has not been filed. Taxpayer promptly makes a request for relief in accordance with this revenue procedure. Taxpayer is not using hindsight in making this request. Furthermore, if Taxpayer were granted an extension of time to make the election, Taxpayer would pay no less tax than if the election had been timely made. Absent other factors, relief would be granted to Taxpayer.

.02 Reliance on professional. Taxpayer hires a tax attorney to advise Taxpayer on preparing Taxpayer's 1992 income tax return and provides the attorney with all information requested. The tax attorney misinforms the taxpayer with respect to an election subject to this revenue procedure. Taxpayer reasonably relies on the tax attorney for advice concerning the election. In 1995, during the examination of the 1992 return by the Service, the examining agent discovers that the election has not been filed. If Taxpayer were granted an extension of time to make the election, Taxpayer would pay no less tax than if the election had been timely made. Taxpayer promptly makes a request for relief in accordance with this revenue procedure, including attaching an affidavit from Taxpayer's tax attorney stating that the tax attorney failed to advise Taxpayer that the election was necessary. Absent other factors, relief would be granted to Taxpayer under this revenue procedure.

.03 Automatic 6-month extension. Taxpayer, a corporation, has a tax department employing both accountants and attorneys. In 1993, one of Taxpayer's staff tax attorneys, unaware of a certain election available to Taxpayer, fails to make an election when the 1992 tax return was filed on March 15, 1993, the due date of the return. This election does not affect the tax liability of any other taxpayer. The statute requires that this election be made by attaching the appropriate form to the Taxpayer's return. Taxpayer may make the election by filing an amended return by September 15, 1993 (6 months from the March 15, 1993 due date) in accordance with section 4.03 of this revenue procedure.
SEC. 8. EFFECT OF AMENDED RETURNS FILED UNDER THIS REVENUE PROCEDURE

.01 Taxpayers requesting and receiving an extension of time under this revenue procedure waive any objections to a second examination under section 7605(b) of the Code. Any second examination is limited to the issue(s) that is the subject of the submission and any correlative adjustments.

.02 When relief is granted under section 6 of this revenue procedure, the Service may require the taxpayer to consent to an extension of time to assess all taxes under section 6501(c)(4) of the Code.

SEC. 9. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 79-63, 1979-2 C.B. 578, which sets forth the information and representations that must be furnished by the taxpayer and the factors that will be considered by the Service in determining whether an extension will be granted for an election or application for relief pursuant to former section 1.9100-1 of the regulations, is superseded.

Rev. Proc. 92-20, 1992-12 I.R.B. 10, is modified by deleting all references to Rev. Proc. 79-63 and replacing them with references to this revenue procedure. Thus, the provisions of this revenue procedure apply for applications received within 90 days after the time required for filing Form 3115.

Rev. Proc. 87-32, 1987-2 C.B. 396, is modified by deleting all references to Rev. Proc. 79-63 and replacing it with references to this revenue procedure. Thus, the provisions of this revenue procedure apply for applications received within 90 days after the time required for filing Form 1128.

SEC. 10. EFFECTIVE DATE

Section 5 of this revenue procedure, concerning automatic extensions, is effective for elections whose due dates (excluding extensions) fall on or after October 1, 1992. Section 6 of this revenue procedure is effective for all applications for relief now being considered by the Service and for all applications for relief submitted on or after October 1, 1992.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Barbara B. Walker of the Office of the Assistant Chief Counsel (Income Tax and Accounting) and Elissa J. Shendalman of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding the applicability of this revenue procedure to accounting method and accounting period elections, contact Robert Testoff of the Office of the Assistant Chief Counsel (Income Tax and Accounting) at (202) 622-4840 (not a toll-free call). For further information regarding the applicability of this revenue procedure to other elections, contact Elissa Shendalman at (202) 622-3040 (not a toll-free call).
### APPENDIX A:

**Elections Prescribed by Regulation That Are Eligible for the Automatic 12-Month Extension**

<table>
<thead>
<tr>
<th>Code Section</th>
<th>Corresponding Reg.</th>
<th>Description of Election</th>
</tr>
</thead>
<tbody>
<tr>
<td>337</td>
<td>1.337(d)-1(a)(2)(ii)</td>
<td>Statement required to be filed with the return in order to deduct the loss on the disposition of stock of a transitional subsidiary.</td>
</tr>
<tr>
<td>337</td>
<td>1.337(d)-1(b)(2)(ii)</td>
<td>Statement required to be filed with the return in order to deduct the loss on the disposition of stock of a transitional parent.</td>
</tr>
<tr>
<td>338</td>
<td>1.338-4T(f)(6)</td>
<td>Protective carryover basis election.</td>
</tr>
<tr>
<td>338</td>
<td>1.338-4T(f)(6)</td>
<td>Offset prohibition election.</td>
</tr>
<tr>
<td>444</td>
<td>1.444-3T Form 8716</td>
<td>Election to use a taxable year other than a required taxable year.</td>
</tr>
<tr>
<td>472</td>
<td>1.472-3 Form 970</td>
<td>Election to use LIFO method.</td>
</tr>
<tr>
<td>505</td>
<td>1.505(c)-1T</td>
<td>15 month rule for filing an exemption application for section 501(c)(9), 501(c)(17), or 501(c)(20) organizations.</td>
</tr>
<tr>
<td>508</td>
<td>1.508-1(a)</td>
<td>15 month rule for filing an exemption application for section 501(c)(3) organizations.</td>
</tr>
<tr>
<td>528</td>
<td>1.528-8</td>
<td>Election to be treated as a homeowners' association.</td>
</tr>
<tr>
<td>754</td>
<td>1.754-1(b)</td>
<td>Election to adjust basis on partnership transfers and distributions.</td>
</tr>
<tr>
<td>911</td>
<td>1.911-7(a)(2)(i)</td>
<td>Election to exclude foreign earned income.</td>
</tr>
<tr>
<td>2032A(d)(1)</td>
<td>20.2032A-8(a)</td>
<td>Estate tax election to specially value qualified real property (where the Service has not yet begun an examination of the filed return).</td>
</tr>
<tr>
<td>2701(c)(3)(C)(i)</td>
<td>25.2701-2(c)(1)</td>
<td>Chapter 14 gift tax election to treat a qualified payment right as other than a qualified payment.</td>
</tr>
<tr>
<td>2701(c)(3)(C)(ii)</td>
<td>25.2701-2(c)(2)</td>
<td>Chapter 14 gift tax election to treat any distribution right as a qualified payment.</td>
</tr>
</tbody>
</table>
## APPENDIX B:

**Elections for Accounting Methods Prescribed by Regulation Eligible for Relief Under Section 5**

<table>
<thead>
<tr>
<th>Code Section</th>
<th>Corresponding Reg. Section, Rev. Proc., etc.</th>
<th>Description of Election</th>
</tr>
</thead>
<tbody>
<tr>
<td>266</td>
<td>1.266-1(c)(3)</td>
<td>Elections to capitalize taxes and carrying charges.</td>
</tr>
<tr>
<td>461(h)</td>
<td>Rev. Proc. 92-29</td>
<td>Election to use the alternative cost method for determining when common improvement costs may be included in the basis of property sold.</td>
</tr>
<tr>
<td>472</td>
<td>1.472-3 Form 970</td>
<td>Election to use LIFO method.</td>
</tr>
<tr>
<td>472</td>
<td>1.472-8(e)(3)(iii)(C) Form 970</td>
<td>Election of an appropriate representative month for selecting an index to determine the current year cost of an inventory pool under the LIFO method.</td>
</tr>
</tbody>
</table>
Chapter 5
Exempt Organization
Tax Research Tools

Instructor Preparation

Estimated Time 2 hours

Reference Materials
- Instructor Guide, Chapter 5, Exempt Organization Tax Research Tools
- Student Guide, Chapter 5, Exempt Organization Tax Research Tools

Training Aids TA 7-1, Objectives

Notes to Instructor Create a flip chart of the Objectives to display throughout the chapter, or create a transparency using TA 5-1.
Chapter 5
Objectives

After completing this chapter you will be able to:

• Explain how information is organized in the IRM

• Describe how to search the IRM for specific information

• List the types of information that can be found on individual EO/BMF accounts
• Identify internet research resources

• Describe the types of information contained in the NERD Drive
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Overview

Instructor Notes
Inform students that the ability to conduct effective research is vital to their success as a Determinations Specialist.

Introduction
Frequently, Exempt Organizations Determinations Specialists conduct research during the processing of their case work. Specialists research specific tax-related questions on the basis of both tax law sources and the specific circumstances surrounding the particular situation.

This chapter introduces you to research tools that Determinations Specialists often use:

- IRM
- Integrated Data Retrieval System (IDRS)
- Exempt Organizations / Business Master File (EO/BMF)
- Commercial Research Services
- Internal Revenue Service website (www.irs.gov)
- NERD Drive

Continued on next page
Overview, Continued

Display and discuss the Objectives, or a review, on the flip chart.

Objectives

After completing this chapter you will be able to:

- Explain how information is organized in the IRM
- Describe how to search the IRM for specific information
- List the types of information that can be found on individual EO/BMF accounts
- Identify internet research resources
- Describe the types of information contained in the NERD Drive

In This Chapter

This chapter contains the following topics:

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<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
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<tbody>
<tr>
<td>Overview</td>
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<tr>
<td>Internal Revenue Manual (IRM)</td>
<td>3</td>
</tr>
<tr>
<td>Integrated Data Retrieval System (IDRS)</td>
<td>5</td>
</tr>
<tr>
<td>Exempt Organizations/Business Master File (EO/BMF)</td>
<td>6</td>
</tr>
<tr>
<td>Commercial Research Services</td>
<td>9</td>
</tr>
<tr>
<td>Internal Revenue Service Website (<a href="http://www.irs.gov">www.irs.gov</a>)</td>
<td>10</td>
</tr>
<tr>
<td>NERD Drive</td>
<td>14</td>
</tr>
<tr>
<td>Summary</td>
<td>17</td>
</tr>
</tbody>
</table>
Overview

The Internal Revenue Manual is the single official source for IRS policies, directives, guidelines, procedures, and delegations of authority in the IRS. Everyone, not just tax practitioners, has access to most of the IRM via the official IRS web-site and the IRS public Reading Room. Some information in the IRM is classified as Official Use Only.

The IRM is a valuable training and research aid. It provides practical information to EO determinations specialists to successfully process exemption applications. The IRM also summarizes and explains published authority. It does not extend or modify published authority and should not be cited either as precedent or authority in deciding cases.

The Exempt Organizations Determinations Manual, designated IRM 7.25, covers the Internal Revenue Code sections that apply to exempt organizations including:

- Qualification of organizations under IRC sections 501 and 521
- Effect of IRC section 502
- Return requirements under IRC section 6033
- Public inspection of approved applications and information returns under IRC section 6104

Continued on next page
The Exempt Organizations Tax Manual, designated IRM 7.27, covers the Internal Revenue Code sections that apply to taxation of exempt organizations. These include:

- Taxation on payment of certain personal benefit contract premiums under IRC section 170(f)(10)
- Taxation pursuant to termination of private foundation status under IRC section 507
- Taxation of unrelated business income under IRC section 511 through IRC section 514
- Taxation of certain transactions under Chapters 41 and 42 of the Code, and
- Other matters concerning the taxation of exempt organizations

The IRM is divided into Parts, Chapters, Sections, Subsections, and Sub-subsections.

Example: IRM 7.25.3.5.1.4- Assisting the Sick or Handicapped (02-23-1999)

<table>
<thead>
<tr>
<th>Part</th>
<th>7 - Rulings and Agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter</td>
<td>25 - Exempt Organizations Determinations Manual</td>
</tr>
<tr>
<td>Section</td>
<td>3 - Religious, Charitable, Educational, Etc., Organizations</td>
</tr>
<tr>
<td>Subsection</td>
<td>5 - Charitable Organizations -- Definition</td>
</tr>
<tr>
<td>Sub-subsection</td>
<td>1 - Relief of the Poor and Distressed or Underprivileged</td>
</tr>
<tr>
<td>Sub-sub-subsection</td>
<td>4 - Assisting the Sick or Handicapped (02-23-1999)</td>
</tr>
</tbody>
</table>
Integrated Data Retrieval System (IDRS)

Instructor Notes

Explain the types of information included in IDRS. Instructor should explain that IDRS information should only be accessed on a need-to-know basis and explain UNAX issues associated with IDRS. If specialists do not have access to IDRS, they would normally request this information from the Processing Department.

Explain when an agent might request the various types of Master File research. Give examples.

Hand out blank BMFOLO prints and review the listed information fields and what each means.

IDRS

IDRS is the acronym for the Integrated Data Retrieval System. It is a computer system used to retrieve/change data on the Individual Master File (IMF), the Business Master File (BMF), and the Exempt Organizations Business Master File (EO/BMF).

The EO/BMF contains the EO sub-module of exempt organizations or applicants. The EO sub-module contains information regarding the name, address, status code, date, foundation status, organization type, etc.

Generally, the EO sub-module is created and updated by the preparation of Form 8670 on EDS when closing a case; however, Form 2363 or Form 2363-A may be required in some instances to add, change, or correct information.

The actual print of the research is commonly referred to as "research." The various types of Master File research that may be needed are as follows:

- EINAD: Secure the employer identification number
- NAMEE: Secure the employer identification number through a name search (preferred)
- ENMOD: Verify that an employer identification number has been assigned and is active
- INOLES: Verify the name and address of the organization and determine information reflected on Master File
- BMFOLO: Similar to INOLES, but more extensive EO sub-module information (most common type of research requested)
## Exempt Organization/Business Master File (EO/BMF)

### Overview

The EO/BMF system, consisting of magnetic tape records, constitutes the basic record source of the IRS for exempt organizations.

EO/BMF is used to:

- Serve as a reference and research tool for IRS personnel assigned to exempt organization programs and activities
- Generate mailing labels for returns, reports, analyses, and lists of exempt organizations to serve district, regional and Headquarters needs
- Provide information for returns processing, audit history, delinquency checking, etc.
- Generate the *Cumulative List of Organizations* described in IRC Section 170(c), commonly known as Publication 78. This list contains the names of organizations which are coded on the EO/BMF as being entitled to receive tax deductible contributions by donors.

### Organizations Included in EO/BMF

In general, organizations included on EO/BMF are those for which an application for exemption has been processed. They include organizations which:

- Are currently exempt
- Have been denied or failed to establish exemption since January 1981
- Have had exemption revoked or have terminated after December 1980

The fact that an organization is not listed on EO/BMF does not mean that the organization is not exempt. The organization may be exempt under law but has not established exemption with the IRS or, for other reasons, may not have been entered on EO/BMF.

*Continued on next page*
<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduced in Chapter 17. Point out the use of Form 2363-A or 2363 and indicate how these are used to keep the files current.</td>
</tr>
</tbody>
</table>

**Form 2363-A and Form 2363**

It is the responsibility of IRS personnel who become aware of an inaccuracy in the EO/BMF record to initiate appropriate action to have the record corrected. Additional research may be required to determine the appropriate corrections.

Many inaccuracies can be corrected on EDS. However, if you are unable to update the information on EDS, you will be required to complete Form 2363-A or Form 2363:

- Form 2363-A is used to add, delete, change, and correct entries on EO/BMF. Certain changes may be input on Form 2363, a shorter version of Form 2363-A.
- After a Form 2363-A or Form 2363 is completed, it is forwarded to our support unit for terminal input processing.

*Continued on next page*
Exempt Organization/Business Master File (EO/BMF), Continued

### Instructor Notes

Explain the process for handling an unpostable situation. Current procedure:

The EO contact is (Please verify that is still the contact since personnel changes may occur.)

When reporting OLE/Unpostable Errors, please do so by secure e-mail sent to the appropriate contact. To help us meet your request more effectively, please indicate in the subject line “UNPOSTABLE” in all caps. You should expect your OLE/Unpostable Error to be addressed the same day it is reported. Errors reported late in the day or from a Western time zone may be addressed the next business day. If your OLE/Unpostable Error is not corrected within 24 hours, please contact Crystal Day.

---

### Unpostables

Unpostables are transactions which attempt to post to Master File but are unable to post because the data is inconsistent with that on Master File.

Sometimes the specialist encounters a mismatch of the employer identification number and name control between EDS and Master File when closing a case. This will cause an unpostable or OLE error and will prevent the case from closing.

Specialists must resolve unpostable transactions according to current procedures before a case can be successfully closed.
Commercial Research Services

**Instructor Notes**

Provide a brief demonstration of each of the research services. Possibly include tutorial information as a handout. Have students attempt to log on to both sites.

Explain how to access the “Find a Federal Tax Document” page that is accessible from Westlaw’s “Welcome” page. Demonstrate how to use the various search engines included on the page.

Explain that, generally, the more specific the search criteria, the more effective the search.

**Westlaw and LexisNexis**

Currently, the IRS contracts with private vendors “Westlaw” and “LexisNexis” to provide specialists with electronic research services. These services, which are accessible from the IRWeb intranet webpage, provide a wide variety of tax, legal, and business news sources. Some examples of information provided are:

- Analytical and explanatory tax services
- Law reviews, journals, and magazines
- Tax treaties and regulations
- State tax materials

In addition, the IRC, Treasury Decisions, Treasury Regulations, Revenue Bulletins, revenue rulings and procedures, court cases, etc. are accessible through these electronic databases.

User training materials are available on both websites.
### Instructor Notes

Demonstrate the following:

- Access the IRS.gov webpage from IRweb using the IRS.gov link.
- Access the Charities & Non-Profits webpage using the hyperlink on the IRS.gov webpage.
- Access the CPE articles: From the Charities & Non-Profits webpage select More Topics - EO Tax Law Training Articles - Exempt Organizations Continuing Professional Education Technical Instruction Program - [Exempt Organizations CPE Topical Index](#).
- Search for a CPE article using the topical index.

---

**www.irs.gov**

The Internal Revenue Service is committed to providing tax payers with world class customer service. The IRS website (pictured below) is one example of a series of electronic products designed to enhance customer service. In addition to offering an enormous database of easily searchable information, the website allows users to view, download, and order IRS forms and publications. The website is a valuable research tool that is widely used by both internal and external customers.

The Charities & Non-Profits page (sample shown on next page) provides useful information on a variety of topics related to exempt organizations.

*Continued on next page*
Instructor Notes

Explain the types of information contained in the CPE articles and why this is such a valuable resource.

CPE Articles

Since 1977, the Exempt Organizations Division of the Internal Revenue Service has annually published a series of articles of interest to tax-exempt organizations, currently known as the Exempt Organizations - Continuing Professional Education (CPE) - Technical Instruction Program. These CPE articles have proven to be a tremendously helpful resource and are frequently accessed by determinations specialists during case processing. CPE articles can be accessed through the Charities & Non-Profits page of www.irs.gov.

Specialists are able to access CPE articles by fiscal year or topical index hyperlinks (sample shown below)


Refer to the Exempt Organizations CPE Topical Index for a cumulative listing of available articles.

You may also order copies of back issues of the program textbook.

Continued on next page
# Exempt Organizations CPE Topic Index Example

**INDEX OF TOPICS**

- Abatement and Waivers ................................................................. 1992-F
- Abortion Rights Mobilization, Inc v. Commissioner ....................... 1987-G
- Acquisition Indebtedness, IRC 514 ................................................. 1986-N
- Advance Approval of Grant-Making Programs, IRC 4945(g) ............. 1984-O
- Advance Ruling Period for New Charities .................................... 1985-A
- Advance Rulings for IRC 507(b)(1)(B) Terminations ....................... 1982-J
- Adverse Determination Cases ....................................................... 1986-I
- Adverse Status Letters ............................................................... 1982-M
- Advertising .............................................................................. 1997-O
- Advertising Income ................................................................. 1989-C
- Advertising Income .................................................................... 1988-F
- Advertising Income, IRC 501(c)(7) Social Clubs ............................ 1996-C
- Advertising, Allocation of Costs to EO Publication ....................... 1982-G
- Advertising, Unrelated Business Taxable Income .......................... 2002-F
- Advertising, Unrelated Business Taxable Income .......................... 1990-F
- Advocacy and Confrontation Activities ........................................ 1979-B
- Affiliations Among Political, Lobbying and Educational Organizations 2000-S
- Affiliated Employers, VEBAs ......................................................... 1984-F
- Affiliated Organizations – Political, Lobbying and Educational Orgs 2000-S
Have students access folders, review what information is included in each of the folders and open various items within each folder.

The NERD Drive was created to enhance consistency by providing information in a location that could be accessed by all determinations specialists regardless of their POD.

The NERD Drive is made-up of the following subfolders:

- BOLO
- Case Assignment Guide
- Denials – Adverse Determinations
- Forms
- Foundation Status
- GCMs
- Group Rulings
- Interim Procedures
- Letters, Paragraphs, Addendums (General)
- NERD Monthly Updates
- Resources
- Rev Procs
- Rev Ruls
- States
- Technical Issues
- Training
- Updates – IRC & Treasury Regulations
- User Fees
NERD Drive, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain how information in the Interim Procedures subfolder may eventually be included in the IRM and deleted from the Interim Procedures subfolder.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Desk Guide</td>
<td>The purpose of the Interim Procedures is to provide “draft” determinations procedures that are not currently included in the IRM. As the draft procedures are added to the IRM they are deleted from the Interim Procedures subfolder.</td>
</tr>
<tr>
<td>Denials –</td>
<td>The purpose of the folder is to provide specialists with sample letters, citable authority, and a consistent format for preparing denial letters.</td>
</tr>
<tr>
<td>Adverse</td>
<td></td>
</tr>
<tr>
<td>Determinations</td>
<td></td>
</tr>
<tr>
<td>Forms</td>
<td>This folder serves as a repository for worksheets, guidesheets, screening documents, and internal forms used in EO Determinations.</td>
</tr>
<tr>
<td>Letters,</td>
<td>This folder contains sample letters for most situations that a determinations specialist encounters. In addition, the folder contains sample paragraphs to use when requesting additional information on a case. Lastly, it contains sample addendums to include on final determination letters.</td>
</tr>
<tr>
<td>Paragraphs,</td>
<td></td>
</tr>
<tr>
<td>Addendums (General)</td>
<td></td>
</tr>
<tr>
<td>Technical</td>
<td>The Technical Issues folder was created to provide technical information on a variety of different tax law issues. Though the information provided is not intended to be all-inclusive, it is quickly accessible and will often provide specialists with a good starting point.</td>
</tr>
<tr>
<td>Issues</td>
<td></td>
</tr>
</tbody>
</table>
Instructor Notes

<table>
<thead>
<tr>
<th>Topic</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Terrorist List</td>
<td>The Terrorist List subfolder contains the most current Excel spreadsheet containing a comprehensive list of Terrorists as well as relevant procedures and training materials. The spreadsheet is updated as needed to add or remove names. The purpose of checking the comprehensive list of names and addresses is to address the suspicion that certain individuals resident in the United States are supporting terrorism through domestic exempt charities. Any case identified as having possible terrorists connections should be discussed with your group manager. The Terrorist List subfolder is found under the Technical Issues folder and Anti-Terrorism subfolder.</td>
</tr>
</tbody>
</table>

Instructor Notes

<table>
<thead>
<tr>
<th>Topic</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Training</td>
<td>The Training folder contains materials from previous training sessions, such as recent CPE sessions.</td>
</tr>
</tbody>
</table>
Summary

Frequently, Exempt Organizations determinations specialists conduct research during the processing of their case work. Specialists research specific tax-related questions on the basis of both tax law sources and the specific circumstances surrounding the particular situation.

The Internal Revenue Manual is the single official source for IRS policies, directives, guidelines, procedures, and delegations of authority in the IRS. Everyone, not just tax practitioners, has access to most of the IRM via the official IRS web-site and the IRS public Reading Room.

IDRS is the acronym for the Integrated Data Retrieval System. It is a computer system used to retrieve/change data on the Individual Master File (IMF), the Business Master File (BMF), and the Exempt Organizations Business Master File (EO/BMF).

The EO/BMF system, consisting of magnetic tape records, constitutes the basic record source of the IRS for exempt organizations.

Currently, the IRS contracts with private vendors “Westlaw” and “LexisNexis” to provide specialists with electronic research services.

The IRS website offers an enormous database of easily searchable information. The website allows users to view, download, and order IRS forms and publications. The website is a valuable research tool that is widely used by both internal and external customers. The Charities & Non-Profits page provides useful information on a variety of topics related to exempt organizations.

The NERD Drive was created to enhance consistency among determinations. It contains a variety information for specialists including forms, worksheets, technical information, access to the terrorist spreadsheet, and training materials.
Chapter 6

Types of Cases/Expedites/User Fees

Instructor Preparation

Estimated Time 2 hours

Reference Materials
- Instructor Guide, Chapter 6, *Types of Cases/Expedites/User Fees*
- Student Guide, Chapter 6, *Types of Cases/Expedites/User Fees*
- Exhibit 6-1, *Case Assignment Guide Case Grading Criteria*
- Exhibit 6-2, *EO Determinations Case Assignment Guide*
- Exhibit 6-3, *Sample of EO Determination Case Assignment Guide Pages*
- Exhibit 6-4, *User Fee Refund Request Form*

Training Aids TA 6-1, *Objectives*

Notes to Instructor Create a flip chart of the *Objectives* to display throughout the chapter, or create a transparency using TA 6-1.
Chapter 6
Objectives

After completing this chapter you will be able to:

• Describe the types of cases received by EO Determinations

• Explain how cases are graded

• Identify which types of applications qualify for expedited processing

• Describe the criteria used when reviewing expedite requests
• Explain the authority for user fee payments
• Determine the proper user fee payments
• Discuss how user fees are processed
• Describe how user fee overpayments are refunded
• Explain the user fee waiver procedures
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Chapter 6
Types of Cases/Expedites/User Fees

Overview

Introduction

As a determinations specialist you will be assigned many different types of cases. You are not limited to processing initial applications for exemption.

Often organizations request that their applications for exemption receive expedited processing. IRM 7.20.2.10 provides the criteria to use when reviewing expedite requests.

User fees have been required on all Forms 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code and Forms 1024, Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120, since February 1, 1988. The determinations specialist must verify that the correct user fee is paid on all Forms 1023 and 1024 applications.

Instructor Notes

Display and discuss the Objectives, or a review, on the flip chart.

Objectives

After completing this chapter you will be able to:

- Describe the types of cases received by EO Determinations
- Explain how cases are graded
- Identify which types of applications qualify for expedited processing
- Describe the criteria used when reviewing expedite requests
- Explain the authority for user fee payments
- Determine the proper user fee payments

Continued on next page
Overview, Continued

Objectives (Continued)

- Discuss how user fees are processed
- Describe how user fee overpayments are refunded
- Explain the user fee waiver procedures

In This Chapter

This chapter contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
<td>1</td>
</tr>
<tr>
<td>Types of Cases</td>
<td>3</td>
</tr>
<tr>
<td>Colored Folders</td>
<td>6</td>
</tr>
<tr>
<td>Case Assignment Guide</td>
<td>8</td>
</tr>
<tr>
<td>Requests for Expedite Service</td>
<td>11</td>
</tr>
<tr>
<td>Working an Approved Expedite Request</td>
<td>14</td>
</tr>
<tr>
<td>User Fee Requirements</td>
<td>15</td>
</tr>
<tr>
<td>User Fee Processing Procedures</td>
<td>18</td>
</tr>
<tr>
<td>Refunds and Waivers</td>
<td>20</td>
</tr>
<tr>
<td>Summary</td>
<td>22</td>
</tr>
<tr>
<td>Exercise 6-1</td>
<td>23</td>
</tr>
<tr>
<td>Exhibit 6-1: <em>Case Assignment Guide Case Grading Criteria</em></td>
<td>25</td>
</tr>
<tr>
<td>Exhibit 6-2: <em>EO Determination Case Assignment Guide</em></td>
<td>27</td>
</tr>
<tr>
<td>Exhibit 6-3: <em>Sample of EO Determination Case Assignment Guide</em></td>
<td>37</td>
</tr>
<tr>
<td>Exhibit 6-4: <em>User Fee Refund Request</em></td>
<td>39</td>
</tr>
</tbody>
</table>
Types of Cases

**Instructor Notes**

Explain and hand out EO Determinations Input Sheet – form is generated when the case is established on RDS at the CPSC and is stapled to the outside of hard copy case files. Explain that there is no input sheet for TEDS cases or hard copy cases that were screened in TEDS (which are I cases only at this time)

Explain where the case type is indicated.

Explain that the case type is also indicated on EDS and TEDS and that they should verify the case type is correct and how this ties into closing the case.

Introduce IRM 7.20. Have students find the section on types of cases.

---

**Instructor Notes**

Review the various types of cases students will be receiving as determinations specialists. Explain some are reserved inventory (e.g. P cases, most A cases).

Explain new regulations for advance ruling may eliminate F cases in the near future. Will be discussed more in depth in Chapter 13.

---

**What the Letters Mean**

Every case assigned to you will have a EO Determination Input Sheet or Case Label on the outside cover of the folder. On each input sheet or case label the type of request is indicated. The following letters are used to identify the type of request or type of case:

- I - Initial Application
- A - Amendment
- P - Termination of PF Status
- F - Foundation Follow-Up
- R - Returned from Review (after closed on EDS)

*Continued on next page*
# Types of Cases, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain what each case type is. Explain that the student may be working more than one case type simultaneously. Example: F and T or A and T.</th>
</tr>
</thead>
</table>

## Types of Cases Defined

**Initial Application (I)**

An initial application is a Form 1023 or Form 1024 submitted by an organization requesting a determination on its exempt status.

**Suspense Case**

If an organization does not respond to our request for additional information the case is updated to suspense status. If the organization later provides the requested additional information, the file is reassigned to the specialist.

The case is worked the same as an “I” case.

**Amendment (A)**

An exempt organization may request a determination on a change in its foundation classification or filing requirements, advance approval of grant making procedures, or other changes to the organization after exemption is granted. These cases are established as “A” cases.

The surviving organization of a merger would be established as an “A” case.

An exempt organization may request exemption for its subordinate organizations by applying for a group ruling. The group ruling request would be established as an “A” case.

*Continued on next page*
### Types of Cases, Continued

<table>
<thead>
<tr>
<th>Types of Cases Defined (continued)</th>
<th>Termination of Private Foundation Status (P)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A private foundation that wishes to be reclassified as a publicly supported organization may request to have its private foundation status terminated.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Foundation Follow-Up (F)</th>
</tr>
</thead>
<tbody>
<tr>
<td>An “F” case may be established upon receipt of Form 8734, <em>Support Schedule for Advance Ruling Period</em> from an organization that was issued an advance ruling on its foundation status at the time it received its initial determination letter with an advance ruling period ending prior to June 9, 2008. At the end of the advance ruling period, the organization is required to demonstrate that it has been publicly supported during the advance ruling period.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Returned, Post Review (R)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A case that has been approved (closed on EDS), the determination letter has been issued and undergoes post review, either by EO Technical or Quality Assurance, which needs further consideration, is assigned a new case number and established on EDS as an “R” case.</td>
</tr>
</tbody>
</table>
Colored Folders

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that cases are placed in two pocket folders and that specific types of cases are jacketed with a separate colored folder.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instructor Notes</td>
<td>Review the types of cases assigned in colored folders. You may want to mention that green and purple folders are not used and that orange folders are used for cases worked in TEDS.</td>
</tr>
</tbody>
</table>

What Do the Colors Mean? Some cases are placed in colored folders for sorting purposes and/or to identify the case for special handling. The following is a partial list of the colored folders currently being used:

- **Pink** - An Expedite Case
  The organization has formally requested expedited treatment of its application.

- **Blue** - “A” and “P” cases
  A blue folder is also used for foundation follow-up cases.

- **Grey** - Review Cases
  All cases returned from EO Quality Assurance are in grey folders.

*Continued on next page*
What Do the Colors Mean? (continued)

**Purple - Congressional**

If a Congressional office contacts the Service on behalf of a constituent, the Taxpayer Advocate Service (TAS) establishes the case as a Congressional case and monitors the progress and resolution of the case.

Also, if an organization has not been successful in resolving problems through normal channels or procedures, the case may be established as a TAS case.

**Magenta – Group Rulings**

The organization has requested a group ruling
Instructor Notes

Case grades and CAG are discussed in detail in Chapter 6.

Explain there are no 5-7-9 case grades; all agents Grade 11 and lower work Grade 11 cases. All students will initially be working Grade 11 cases as trainees and advanced trainees.

Assignments of Case Grade Level

The initial or presumptive case grade when a case is established is grade 11. Each case is assigned a case grade during the screening process based on the current Case Assignment Guide. Case grades are 11, 12, and 13 and are indicated on the EO Determination Input Sheet or Case Label.

Cases are assigned by case grade to a determinations specialist with that grade. Trainees work grade 11 cases.
Instructor Notes

Exhibit 6-1: Case Assignment Guide Matrix.

### How Grades are Determined

A matrix is used in identifying which grade types of cases are given. The matrix describes the case complexity or difficulty of the following factors:

- Analysis of Application
- Factual Complexity of Issues
- Application of Tax Law
- Interpersonal Skills
- Impact of Work

From that matrix (See Exhibit 6-1), a chart called the Case Assignment Guide (CAG) was designed and is used to assist the specialist in determining the grade of a case. The CAG lists organization types and activities and specifies the typical grade of the case.

**NOTE:** Case grades may be changed (either upgraded or downgraded) by the Group Manager.

If you receive a case that is graded higher than your current grade, whether identified by the screener or not, you should discuss the case with your group manager prior to beginning work on the case.

For example, if you are a Grade 11 and are assigned a case that is an application for an organization operating low-income housing, the case should be discussed with the group manager. The case may be upgraded by the manager and may be reassigned to a Grade 12 specialist.

*Continued on next page*
Case Assignment Guide (CAG), Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain how the new CAG is laid out – three sections which provide varying levels of information.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CAG Features</strong></td>
<td>The most recent version of the CAG was expanded from simply listing case grades to providing information on how the complexity matrix was applied to the organization types and activities. The CAG also lists applicable tax law (generally revenue rulings) providing a basis for the exemption of the activity.</td>
</tr>
</tbody>
</table>

The electronic CAG available on the NERD has three tabs which provides three different levels of case grade information:

- **Summary of activities by grade:**
  Lists activities and organization types sorted by category and case grade

- **Condensed listing of activities and applicable tax law:**
  Lists activities and organization types alphabetically by category and provides an applicable tax law reference as well as the case grade

- **Detailed listing of activities and applicable tax law:**
  Lists activities and organization types alphabetically by category and provides detailed information on the application of the case grade criteria including applicable tax law references as well as the case grade

Exhibit 6-2 shows the entire summary of activities by grade and Exhibit 6-3 provides examples of the information available on the other tabs of the CAG.
Requests for Expedite Service

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain what it means to have a case expedited.</th>
</tr>
</thead>
</table>

**Expedite Processing - What? Who?**

Expedite requests are made by organizations who, for various reasons, want the Service to process their cases ahead of other cases. Cases are generally assigned in control date (postmark date) order; however, if expedite service is approved, that case is moved ahead of cases with older control dates.

IRM 7.20.2.10 provides the requirements for processing expedite requests.

The requests **must**:

- Be in writing
- Contain a compelling reason

Who is responsible?

- The Manager, EO Determinations or
- The person to whom he/she delegates authority

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain the various situations for expedite treatment.</th>
</tr>
</thead>
</table>

**Expedite Situations**

There are four situations in which expedite requests may be approved:

1. When a grant to the applicant is pending and the failure to secure the grant may have an adverse impact on the organization’s ability to continue operations
2. When the purpose of the newly created organization is to provide disaster relief to victims of emergencies such as flood and hurricane
3. When there have been undue delays in issuing a letter caused by problems within IRS
4. In any situation where the Manager, EO Determinations or his/her delegate feels expedited service is warranted

Continued on next page
Requests for Expedite Service, Continued

### Instructor Notes

Explain that requests are generally identified and reviewed by screener and Processing Unit prior to case assignment.

Explain when the specialist would process an expedite request and what information is specifically required in writing for consideration. Good resource is irs.gov site: Form 1023: Expediting Application Processing http://www.irs.gov/charities/article/0,,id=139805,00.html

### Determinations Specialists Sometimes Make Expedite Decisions

Applications which have expedite requests are normally identified prior to being assigned to a determinations specialist. Expedite requests are processed in the Screening group. Once a case is approved for expedite service, it is placed in a pink folder.

If you are assigned a case and the organization subsequently requests expedite treatment or if you find an expedite request in the case file and it appears that the expedite request was never processed:

- **You** must make the determination on the expedite request in consultation with your manager
- **Do not** forward it to the Screening Group
- If the request meets the expedite criteria provided in IRM 7.20.2.10 you should work the case ahead of all others in your inventory.
- If the request does not meet the expedite criteria, you should process the application, as you would any other application, in control date order.

---

Continued on next page
**Requests for Expedite Service, Continued**

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Briefly explain that this form is included with every case and is updated each time an action is taken on a case. More information will be provided in Chapter 7.</td>
<td></td>
</tr>
</tbody>
</table>

**Documentation of Case Chronology Record (CCR)**

A case chronology record (CCR) documents all actions taken on a case. It is completed on Form 5464-A and is maintained for every case file. Documenting the case chronology record is discussed in Chapter 6, *Introduction to Case Development and Documentation*.

The case chronology record should include thorough documentation of the expedite request including the following:

- All consultations with the group manager regarding the expedite request
- All discussions with the applicant organization regarding the expedite request
Working an Approved Expedite Request

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Have students find references to Expedites in IRM 7.20.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Stress the importance of giving prompt attention to these types of cases.</td>
</tr>
</tbody>
</table>

**Working an Expedite**

When working an “expedite approved” application, you should work closely with the organization. If you need additional information, use the following guidelines:

- Call rather than write, if possible. Always remember to document your case chronology.

- If you must write an additional information letter, offer to fax the letter and encourage the organization to fax its response.

- Advise the taxpayer that the sooner they provide you with the additional information, the sooner you can complete processing the application.

**Expediting Review**

To ensure everyone else knows the case needs special attention, be sure the case is in a pink folder.
# User Fee Requirements

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that a determination cannot be issued unless the proper user fee has been paid.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Point out to the students the authority for the user fee and Rev. Proc. 20XX-8.</td>
</tr>
</tbody>
</table>

**Authority**

The Revenue Act of 1987, section 10511, Public Law 100-203, 1987-3 C.B. 282, requires the payment of user fees by taxpayers for rulings, opinion letters, and determination letters.

| Instructor Notes | Explain the importance of determining and procuring the proper user fee amount. |

**Specific Fees**

The specific fees for exempt organization determination letters are listed in a revenue procedure that is updated annually and is generally published as a Revenue Procedure 2012-8 (updated annually). User fees are located in Section 6.06 of the revenue procedure. There are three types of requests:

<table>
<thead>
<tr>
<th>Request Type</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. An organization that has had annual gross receipts averaging not more than $10,000 during the preceding 4 years, or</td>
<td></td>
</tr>
<tr>
<td>A new organization that anticipates gross receipts averaging not more than $10,000 during its first 4 years.</td>
<td>$400</td>
</tr>
<tr>
<td>2. An organization that has had annual gross receipts averaging more than $10,000 during the preceding 4 years, or</td>
<td></td>
</tr>
<tr>
<td>A new organization that anticipates gross receipts averaging more than $10,000 during its first 4 years.</td>
<td>$850</td>
</tr>
<tr>
<td>3. Group exemption letters</td>
<td>$3,000</td>
</tr>
</tbody>
</table>

*Continued on next page*
Instructor Notes

Give example of when more than one user fee is due – group rulings – remind students that group rulings are a reserved category but requests are not always identified in screening.

Two Letters?

If an organization is requesting both an individual ruling and a group ruling letter, it must pay two separate user fees.

Example:

If an organization’s annual gross receipts four-year average is $25,000, and if the organization submits both a request for an individual determination letter and a group exemption determination letter, then the organization would be required to pay $3,850 ($850+$3,000). This is the only time there will be two fees paid.

Instructor Notes

Explain what a private letter ruling is and how it differs from a determination. Explain fee is $10,000 and all requests are sent to DC.

Private Letter Ruling (PLR)

A request for a ruling on prospective and proposed activities that have not been covered in the initial determination letter is required if the organization wants reliance that its tax exemption will continue. The organization must request a private letter ruling (PLR) from EO Technical in Washington, DC. User fees associated with these requests are also outlined Rev. Proc. 2012-8, section 6.06. The current user fee for a private letter ruling is $10,000.
User Fee Requirements, Continued

**Instructor Notes**

Explain Form 1023 – page 12; Form 1024 – 8718.

**User Fee Form**

The user fee for organizations applying on Form 1023 is requested in Part XI of Form 1023.

User fee payments for organizations applying on Form 1024 or applying for a group ruling should be attached to Form 8718, *User Fee Exempt Organization Determination Letter Request.*

**Instructor Notes**

Explain certification signature is required for the $300 user fee.

**Certification on Form 8718 for Form 1024**

If an organization is applying on Form 1024 determines that its annual gross receipts will average less than $10,000 and pays the $400 user fee, it must also sign the following certification on Form 8718:

**Certification**

I certify that the annual gross receipts of __________________________ have averaged (or are expected to average) not more than $10,000 during the preceding 4 (or the first 4) years of operation.

Signature ___________________________ Title ____________________
# User Fee Processing Procedures

<table>
<thead>
<tr>
<th>Determinations Specialist Responsibilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Determinations specialists have the following user fee responsibilities:</td>
<td></td>
</tr>
<tr>
<td>• Verify that the correct user fee amount was submitted with the Form 1023/1024</td>
<td></td>
</tr>
<tr>
<td>• Verify that the certification was signed on Form 8718, if the applicant organization paid the $400 user fee and is applying on Form 1024</td>
<td></td>
</tr>
<tr>
<td>• Secure additional user fee, if required</td>
<td></td>
</tr>
<tr>
<td>• Process user fee refund, if applicable</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain the specialists’ responsibilities in processing user fee requests.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Verify Correct User Fee Was Paid</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>You should review the following sections on Form 1023/1024 to verify that the correct user fee was paid:</td>
<td></td>
</tr>
<tr>
<td>• Form 1023, Part IV and Form 1024, Part II provide a narrative of the organization’s activities. If the activities are not consistent with the organization’s financial information, you should contact the organization for clarification.</td>
<td></td>
</tr>
<tr>
<td>For example, the financial information provided on Form 1023/1024 shows average annual gross receipts below $10,000. However, the narrative of activities shows that the organization plans to operate a school with a paid staff. A school with a paid staff cannot normally operate on annual budgets below $10,000.</td>
<td></td>
</tr>
<tr>
<td>• After reviewing Form 1023, Part IX or Form 1024, Part V, Financial Information, you should compute the average annual gross receipts for a four year period to determine if the average annual gross receipts are above or below $10,000.</td>
<td></td>
</tr>
</tbody>
</table>
| Instructor Notes | Stress that a case cannot be closed without the proper user fee.  
Explain that the user fee section of the published IRM is currently out of date. |
|------------------|-----------------------------------------------------------------|

**User Fee Procedures**

User fee problems are usually detected at the time the case is screened. These cases are usually designated for Reserved Inventory for processing. If you are working the case, it is your responsibility to resolve the user fee problem.

These procedures are followed by determinations specialists:

1. If a case comes through with no user fee paid, send it to the Adjustments Unit for them to secure the user fee.
2. If the user fee is inconsistent with the financial data submitted, request the user fee, along with any other needed information, in writing.
   - If the organization does not respond and the user fee is the only issue, close the case Failure to Establish (FTE).
   - If the organization responds and states it does not owe the user fee, the organization should be contacted for further explanation.
3. If the financial information is not consistent with the organization’s activities (e.g., a housing organization provided a projected average annual budget that is less than $10,000 and paid $400), a letter is sent to the organization to clarify the user fee issue and/or budget.
4. User fees received with correspondence are generally processed by the Adjustments Unit. Verification of receipt of the user fee is forwarded to the specialist.

User fee procedures are found in IRM 7.20.2.9.

**Documenting the CCR**

Determinations specialists should document the receipt of any additional user fee payments on the CCR.
Refunds and Waivers

Instructor Notes

Explain that there are situations where user fees are refunded or waived.

Instructor Notes

Explain the various situations in which a user fee will be refunded.

Exhibit 6-3: User Fee Refund Request form

Refunds

Sometimes an applicant organization will pay too much user fee and a refund is appropriate. If during your review of an application you find that an applicant has overpaid the user fee you should:

- If writing for additional information, include a statement that the applicant overpaid and will be issued a refund under separate cover.
- If no additional information letter is required, call the organization and advise it that the user fee was overpaid and a refund will be issued under separate cover. Document your Case Chronology Record.
- On cases to be closed, prepare a routing slip advising the user fee adjuster of both the reason for the refund and the amount of the refund. This routing slip must be signed by your manager. Prepare Form 3198-A, Special Handling Notice, checking the box under Determination Cases, EO, User Fee – Refund. These cases are forwarded to the Adjustments Unit for processing of the refund.

User fees are also refunded in the following situations:

- When it is discovered that the organization is part of a group ruling and the organization wishes to remain a part of the group.
- When a higher user fee is due and the organization does not want to continue processing due to inability or lack of desire to pay the higher fee.

(See Exhibit 6-4 for the User Fee Refund Request)
Refunds and Waivers, Continued

| Instructor Notes | Give examples of when a waiver request would be denied and when it would be approved. |

Waivers

An organization may request a waiver of an additional user fee. The request is often based on Service error. The Manager, Exempt Organizations Determinations Quality Assurance has the final authority to approve or disapprove a waiver request. User fee waivers are discussed in section 10 of Rev. Proc. 2012-8.

If an organization requests in writing that we waive a user fee due to Service error and you agree that the user fee should be waived, process the case as normal and document in the CCR the rationale for waiving the user fee. A waiver based on Service error may be approved by the group manager.

If an organization requests in writing that we waive a user fee and you do not feel there was a Service error or the request is for reasons other than Service error:

- The request should contain an explanation of the reason for the request including a chronology of events from the date the response was due to the date of the waiver request. If necessary, secure additional information to determine whether there is a Service error.
- Discuss the approval or denial of the waiver with your group manager. You will follow the guidance of the manager.
- Prepare a routing slip indicating why the request should be approved or denied and submit it to the group manager along with the case file.
- Requests for waivers should be forwarded to Quality Assurance via Form 3210, Document Transmittal.
- The reviewer will review the case file upon receipt so that it can be returned to the specialist. If the reviewer does not agree with the specialist’s recommendation he/she will prepare a summary of facts and explain why.
- The summary prepared by the specialist and/or reviewer will remain with the file to serve as a work paper.
- When the case is returned from Quality Assurance, prepare a letter to the applicant (to be developed) advising them of the decision.
Summary

Cases are established and processed by case type. The case type is listed on the front of the case file as follows:

- I - Initial Application
- A - Amendment
- P - Termination of PF Status
- F - Foundation Follow-Up
- R - Returned from Review (after closed on EDS)

Some cases are placed in colored folders for sorting purposes and/or to identify the case for special handling. These colors include pink, blue, grey, green, and magenta.

Each case is assigned a case grade during the screening process based on the current Case Assignment Guide. A matrix is used in identifying which grade types of cases are given. The CAG provides information on how the complexity matrix was applied to the organization types and activities. It also lists applicable tax law (generally revenue rulings) providing a basis for the exemption of the activity.

Expedite requests are made by organizations who want the Service to process their cases ahead of other cases. These requests must be in writing and contain a compelling reason. Expedite requests should be worked ahead of other cases and you should work closely with the organization.

User fees are required for organizations seeking determination letters. Currently, organizations with revenues of $10,000 or less pay a user fee of $400, organizations with revenues over $10,000 pay $850, and organizations seeking a group exemption pay $3,000. Determination Specialists are responsible for ensuring organizations have paid the correct user fee with their application. Refunds of overpayments and waivers of user fees happen occasionally and should be processed based on current procedures.
Exercise 6-1

Instructor Notes
Administer and go over answers to Class Exercise.

1. Which type of case will be established in the following situation?

**Case types: A, F, I, P, R**

- A Form 1023 is submitted __I__
- An organization submits Form 8734 at the end of its advance ruling period __F__
- A private foundation wishes to be reclassified as a public charity __P__
- An organization requests a group ruling determination __A__

2. Which of the following are placed in a blue folder?

(a) A Case
(b) F Case
(c) I Case
(d) P Case

**Answer:** (a), (b) and (d) – All A, F and P cases are placed in blue folders.

3. The Manager, EO Determinations is notified of all expedite requests and informs the determinations specialist whether the expedite request is approved.

(a) True (b) False

**Answer:** False The screener or the assigned specialist makes the determination whether the case meets expedite criteria.
4. Which of the following user fees would be applicable for an exemption determination letter for an organization whose gross receipts average $15,000 per year?

(a) $400  
(b) $500  
(c) $850  
(d) $3,000

Answer: (c) The user fee for organizations with receipts exceeding $10,000 is $850

5. An applicant can be refunded its user fee if it does not like the specialist with whom it is working.

(a) True  (b) False

Answer: False An organization may only be refunded its user fee if it paid too much user fee based on its budgets; it is determined the organization was already exempt under an individual or group exemption and wishes to remain within the already exempt subsection or under the group ruling; or a higher user fee is due and the organization does not wish to continue processing the exemption due to an inability or lack of desire to pay the higher fee.
<table>
<thead>
<tr>
<th>CASE COMPLEXITY FACTORS</th>
<th>GRADE LEVEL DISTINCTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GS-11</td>
</tr>
<tr>
<td><strong>Analysis of Application</strong></td>
<td>Application is basic; facts regarding nature and purpose are easily discernible. Private benefit/inurement issues unlikely but possible.</td>
</tr>
<tr>
<td><strong>Factual Complexity of Issues</strong></td>
<td>Issues are of average complexity and sensitivity. Established case development methods and procedures are usually adequate.</td>
</tr>
<tr>
<td><strong>Application of Tax Law</strong></td>
<td>Tax laws are in most cases applicable but occasionally involve unusual interpretation and application.</td>
</tr>
<tr>
<td><strong>Interpersonal Skills</strong></td>
<td>Contacts are with representatives of applicants, organization members and contributors. Tact and diplomacy are required to resolve and elicit information and resolve questions and problems.</td>
</tr>
<tr>
<td><strong>Impact of Work</strong></td>
<td>Determination decision may impact other organizations; applicant’s sole source of income may be from donations; and, the likelihood of media attention is limited.</td>
</tr>
</tbody>
</table>

Revised November 25, 2002
### Exhibit 6-2 (Page 1 of 7)

#### Animal Related

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prevention of Cruelty to Animals</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Arts, Culture & Humanities

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Art Exhibit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Art Sale</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fairs or Festivals</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Genealogical Activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Historical Site and Monument</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Museums, Zoos, and Planetariums</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Patriotic Activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Publishing Activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Theatre or Performance Group</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Film Production</td>
<td></td>
<td>Radio and Television Broadcasting</td>
</tr>
</tbody>
</table>

#### Civil Rights, Social Action & Advocacy

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Action Organizations:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Alcohol, Drugs, Narcotics or Tobacco</td>
<td>Other Action Organizations that Propose, Support or Oppose Legislation</td>
<td></td>
</tr>
<tr>
<td>• Environment Issues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Pornography</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Protection of Consumer Interests</td>
<td>Provide Facilities or Services for Political Campaign Activities</td>
<td></td>
</tr>
<tr>
<td>• Sex Education, Birth Control, Legalized Abortion, Population Control</td>
<td>Voter Information on Issues or Candidates</td>
<td></td>
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<tr>
<td>• Transportation</td>
<td></td>
<td></td>
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<tr>
<td>• Urban Renewal</td>
<td></td>
<td></td>
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<tr>
<td>• Zoning Issues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Human and Civil Rights Organizations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Action Organizations that Propose, Support or Oppose Legislation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provide Facilities or Services for Political Campaign Activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Voter Information on Issues or Candidates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Voter Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Voter Registration - 4945(f)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conflicts between State and Federal Law</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Propose, Support or Oppose Legislation - extensive use of internet</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Support, Oppose or Rate Political Candidates - extensive use of internet</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Community Improvement & Capacity Building

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Combating Community Deterioration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Community Promotion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Community Service Organization</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crime Prevention</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Homeowners Association</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry Trade Shows and Conventions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lessen Neighborhood Tensions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans or Grants for Minority Business</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotion of Fair Business Practices</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Title Holding Corporation - 501(c)(2)</td>
<td></td>
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</tbody>
</table>

### Crime and Legal Related

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal Aid Society</td>
<td>Prepaid Legal Services Plan - 501(c)(20)</td>
<td>Public Interest Law Firms</td>
</tr>
<tr>
<td>Rehabilitation of Convicts and Exconvicts</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Education

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alumni Association</td>
<td>Charter Schools (Managed by For-Profit)</td>
<td>Charter School Management Company</td>
</tr>
<tr>
<td>Charter Schools (No For-Profit Management Company)</td>
<td>Private Schools (Mississippi and Louisiana or evidence of related party transactions)</td>
<td>Cooperative Service Organization - 501(f)</td>
</tr>
<tr>
<td>Booster Clubs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Faculty Group</td>
<td>Student Housing</td>
<td></td>
</tr>
<tr>
<td>Fraternity or Sorority</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Library</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Literacy Activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Schools (not Mississippi or Louisiana and no evidence of substantial related party transactions)</td>
<td></td>
<td></td>
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<tr>
<td>PTOs</td>
<td></td>
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<tr>
<td>Scholarships</td>
<td></td>
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<tr>
<td>School Athletic Association</td>
<td></td>
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<tr>
<td>Student Exchange with Foreign Country</td>
<td></td>
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<tr>
<td>Student Loans and Aid</td>
<td></td>
<td></td>
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<tr>
<td>Student Operated Businesses</td>
<td></td>
<td></td>
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<tr>
<td>Student Organizations</td>
<td></td>
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## Exhibit 6-2 (Page 3 of 7)

### EO Determination Case Assignment Guide, Continued

<table>
<thead>
<tr>
<th>Employment</th>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apprentice Training</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Association of Employees</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Job Training, Counseling, or Assistance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labor Union or Organization - 501(c)(5)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Environment</th>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beautification Activities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Educational Conservation and Environmental Activities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Garden Club</td>
<td></td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Food, Agriculture &amp; Nutrition</th>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural or Horticultural Organization - 501(c)(5)</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Farmer's Market</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Farming Cooperative Marketing or Purchasing - 521</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Health Care

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Community Health Planning</td>
<td>Cooperative Hospital Service Organization - 501(e)</td>
<td>Abortion Clinic</td>
</tr>
<tr>
<td>Family Planning</td>
<td>Health Bank (Blood, Milk, Sperm)</td>
<td>Accountable Care Organizations</td>
</tr>
<tr>
<td>General Health Services</td>
<td>Skilled Nursing Facility</td>
<td>Electronic Health Records / Regional Health Information Organizations</td>
</tr>
<tr>
<td>Health Clinic and Rural Medical Facility (including Federally Qualified Health Centers)</td>
<td>Telemedicine</td>
<td>Group Medical Practice and In-Faculty Group Practice Association</td>
</tr>
<tr>
<td>Hospital Auxiliary</td>
<td></td>
<td>Hospital and some health care clinics per IRM 7.26.2.4.1.1(3).</td>
</tr>
<tr>
<td>Mobile Health Unit (Mammography, Ultrasounds, Pregnancy Testing, etc.)</td>
<td></td>
<td>Other &quot;Hospital&quot; Organizations</td>
</tr>
<tr>
<td>Nurses Register</td>
<td></td>
<td>- Integrated Delivery Systems</td>
</tr>
<tr>
<td>Rescue and Emergency Services</td>
<td></td>
<td>- HMO's and PPO's</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Physician Hospital Organizations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Managed Care Purchasing Organizations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Medical Sharing Plan / Health Care Sharing Ministry (whose members share a common set of ethical or religious beliefs)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>State Sponsored High Risk Insurance - 501(c)(26)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>State Sponsored Workers Compensation - 501(c)(27)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Qualified Non-Profit Health Insurance Issuers - 501(c)(29)</td>
</tr>
</tbody>
</table>

## Housing & Shelter

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instruction and Guidance on Housing</td>
<td>Down Payment Assistance</td>
<td>Partnerships / Low Income Housing Tax Credits</td>
</tr>
<tr>
<td>Other Housing Activities (Transitional, Temporary, etc.)</td>
<td>Housing for the Elderly or Disabled</td>
<td>Foreclosed Home - Acquisition, Rent or Sales</td>
</tr>
<tr>
<td></td>
<td>Low and Moderate Income Housing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Student Housing</td>
<td></td>
</tr>
</tbody>
</table>
**Human Services**

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
<th>Grade 13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Day Care Center</td>
<td>Gifts, grants or loans to individuals (other than scholarships)</td>
<td>Credit Counseling - Credit Repair, Debt Management Plans, Bankruptcy Counseling or Substantial Financial Literacy</td>
</tr>
<tr>
<td>Referral Service (Social Agencies)</td>
<td>Services for the Elderly or Handicapped</td>
<td>Foreclosure Assistance</td>
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<tr>
<td>Thrift Shop, Retail Outlet, etc.</td>
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</table>

**International, Foreign Affairs & National Security**

<table>
<thead>
<tr>
<th>Grade 11</th>
<th>Grade 12</th>
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</thead>
<tbody>
<tr>
<td>Foreign Organization (includes organizations formed in US Territories)</td>
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<td>Foreign Conduits</td>
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**Mental Health & Crisis Intervention**

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<tr>
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<tbody>
<tr>
<td>Counseling</td>
<td>Mental Health Care</td>
<td></td>
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<tr>
<td></td>
<td>Rehabilitating Alcoholics, Drug Abusers, Compulsive Gamblers, etc.</td>
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**Mutual & Membership Benefit**

<table>
<thead>
<tr>
<th>Grade 11</th>
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</thead>
<tbody>
<tr>
<td>Fraternal Beneficiary Society, Order or Association - 501(c)(8) or 501(c)(10)</td>
<td>Voluntary Employee Beneficiary Association (VEBA) - 501(c)(9)</td>
<td>Assigned Risk Insurance Activities</td>
</tr>
<tr>
<td>Perpetual Care Fund</td>
<td>Supplemental Unemployment Benefit Plan (SUB) - 501(c)(17)</td>
<td>Health Insurance and Prepaid Group Health Plan</td>
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<tr>
<td>Cemetery or Burial Activities</td>
<td></td>
<td>Mutual Insurance Company - 501(c)(15)</td>
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<td>Underwriting Municipal Insurance</td>
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**Philanthropy, Volunteerism & Grantmaking Foundations**

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<tr>
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<tr>
<td>4945(g)</td>
<td>4947(a)(1) Trust</td>
<td>4940(d) Exempt Operating Foundations</td>
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<tr>
<td>Community Chest, etc.</td>
<td>4947(a)(2) Trust</td>
<td>4942(g) Set-Asides</td>
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<tr>
<td>Community Trust or Component</td>
<td>Endowment Fund or Financial Services</td>
<td>Investments in Hedge Funds</td>
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<tr>
<td>Fundraising - Athletic or Sports Event (golf tournament)</td>
<td>Donor Advised Fund</td>
<td>Fundraising as Primary Activity - conducted solely via the internet (auction or professional fundraising arrangement)</td>
</tr>
<tr>
<td>Gifts, Grants, Loans, Facilities to Organizations</td>
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### EO Determination Case Assignment Guide, Continued

#### Public & Societal Benefit

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<tr>
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<tr>
<td>Erection or Maintenance of Public Building or Works</td>
<td>Consumer Interest Group</td>
<td>Credit Union - 501(c)(14)</td>
</tr>
<tr>
<td>Mutual Ditch, Irrigation, Telephone, Electric Co., or Like Organization - 501(c)(12)</td>
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<td>Federal Instrumentality - 501(c)(1)</td>
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<tr>
<td>Veterans Activities</td>
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<td>Reserve Funds or Insurance for Domestic Building and Loan Assoc., Cooperative Bank, or Mutual Savings Bank - 501(c)(14)</td>
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<td>State or Local Instrumentality</td>
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#### Public Safety, Disaster Preparedness & Relief

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<tr>
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<tbody>
<tr>
<td>Emergency or Disaster Aid Fund</td>
<td>Testing Products for Public Safety</td>
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<tr>
<td>Voluntary Firemen's Organization or Auxiliary</td>
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#### Recreation & Sports

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<tr>
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<tbody>
<tr>
<td>Amateur Athletic Organization - adult education or recreation in a sport</td>
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<td>Professional Athletic Team</td>
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<tr>
<td>Community Center or Recreation Facility</td>
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<td>Social Clubs - Activity conducted solely via internet</td>
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<tr>
<td>Fostering National or International Sports Competition - 501(j)</td>
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<tr>
<td>Hobby Clubs and Social Clubs</td>
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<td>Youth Sports</td>
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#### Religion-Related

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<tr>
<td>Association of Churches</td>
<td>Religious Order - 501(d)</td>
<td>Non-Traditional Church - activities conducted solely via internet</td>
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<tr>
<td>Church</td>
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<tr>
<td>Church Auxiliary</td>
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<tr>
<td>Evangelism</td>
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<tr>
<td>Missions and Missionary Activities</td>
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<tr>
<td>Other Religious Activities</td>
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<tr>
<td>Religious Publishing Organizations</td>
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#### Research

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<tbody>
<tr>
<td>Study and Research Groups (non-scientific)</td>
<td>Research, Development and Testing for an Industry</td>
<td>Medical Research</td>
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<td>Scientific Research</td>
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#### Youth Development

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<tr>
<td>(b) (3) (A)</td>
<td>(b) (3)</td>
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<tr>
<td>Youth Camps, etc.</td>
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<tr>
<td>Prevention of Cruelty to Children</td>
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#### Miscellaneous

Note: this section includes specific "problems" present in cases, rather than the applicant's purpose. If an applicant exhibits one of these issues, the grade shown here will take precedent over a lower grade shown elsewhere on the CAG

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<thead>
<tr>
<th>Grade 11</th>
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<tr>
<td>Foundation Follow-up Cases</td>
<td>Consulting Services</td>
<td>509(a)(3) - Abusive</td>
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<tr>
<td>Limited Liability Corporations - Organizational Test</td>
<td>For-Profit Related (including successor)</td>
<td>509(a)(3) - Type III (Including Reclassifications)</td>
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<tr>
<td></td>
<td>Gaming (primary activity)</td>
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<tr>
<td>Terminations of PF Status</td>
<td>Group Ruling</td>
<td>Internet Service Provider</td>
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<tr>
<td>990 Filing Exemption</td>
<td>Indian Tribal Governments or Cultural Activities</td>
<td>Previously Revoked or Denied Organizations (does not include Auto Revoked)</td>
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<td></td>
<td>Lessening the Burdens of Government</td>
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<tr>
<td></td>
<td>Limited Liability Corporations - Operational Test</td>
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<td>New Markets Tax Credit</td>
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<td></td>
<td>Potential Terrorism, Fraud or Abusive Schemes</td>
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<td>Professional Fundraiser</td>
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## Sample EO Determination Case Assignment Guide, Summary Application of Tax Law

<table>
<thead>
<tr>
<th>Activity</th>
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<tbody>
<tr>
<td><strong>Animal Related</strong></td>
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<tr>
<td>Prevention of Cruelty to Animals</td>
<td>RRs 66-359, 67-293, and 74-194.</td>
<td>Grade 11</td>
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<tr>
<td><strong>Arts, Culture &amp; Humanities</strong></td>
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<tr>
<td>Art Exhibit</td>
<td>RRs 71-395 and 76-152</td>
<td>Grade 11</td>
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<tr>
<td>Art Sale</td>
<td>RRs 66-178, 71-395, and 76-152</td>
<td>Grade 11</td>
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<tr>
<td>Fairs or Festivals</td>
<td>RR 67-216</td>
<td>Grade 11</td>
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<tr>
<td>Film Production</td>
<td>RRs 75-471 and 76-4</td>
<td>Grade 12</td>
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<tr>
<td>Genealogical Activities</td>
<td>RRs 80-301 and 80-302</td>
<td>Grade 11</td>
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<tr>
<td>Historical Site and Monument</td>
<td>RR 75-470</td>
<td>Grade 11</td>
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<tr>
<td>Museums, Zoos, and Planetariums</td>
<td>RRs 67-216, 68-372, and 71-545.</td>
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<td>Patriotic Activities</td>
<td>RRs 68-263, 68-455, and 78-84</td>
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<td>Publishing Activities</td>
<td>RRs 66-147, 67-4, 75-471, and 76-4</td>
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<tr>
<td>Radio and Television Broadcasting</td>
<td>RR 66-220</td>
<td>Grade 12</td>
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<tr>
<td>Theatre or Performance Group</td>
<td>RRs 61-175, 65-271, 67-327, 73-45, 75-471, and 80-286</td>
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<tr>
<td><strong>Civil Rights, Social Action &amp; Advocacy</strong></td>
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<td>Action Organizations:</td>
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<td>Grade 11</td>
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<tr>
<td>• Alcohol, Drugs, Narcotics or Tobacco</td>
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<tr>
<td>• Environmental Issues</td>
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<td>• Pornography</td>
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<td>• Protection of Consumer Interests</td>
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<td>• Sex Education, Birth Control,</td>
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<td>Legalized Abortion, Population Control</td>
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<tr>
<td>• Transportation</td>
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<tr>
<td>• Urban Renewal</td>
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<tr>
<td>• Zoning Issues</td>
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<td>Big Mama Rag, Inc. v. United States, 631 F.2d 1030 (D.C. Cir. 1980); National Alliance v. United States, 710 F.2d 868 (D.C. Cir. 1983); RR 67-293; Rev Proc 86-43</td>
<td>Grade 11</td>
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<tr>
<td>Big Mama Rag, Inc. v. United States, 631 F.2d 1030 (D.C. Cir. 1980); National Alliance v. United States, 710 F.2d 868 (D.C. Cir. 1983); RR 67-293; Rev Proc 86-43</td>
<td>Grade 13</td>
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<tr>
<td>Conflicts between State and Federal Law</td>
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<td>Grade 13</td>
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IRS 01297
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<tr>
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<tr>
<td>Propose, Support or Oppose Legislation</td>
<td>501(h); RRs 61-177, 67-293, 70-449, and 76-147</td>
<td>Grade 12</td>
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<tr>
<td>Propose, Support or Oppose Legislation - extensive use of internet</td>
<td>501(h); RRs 61-177, 67-293, 70-449, and 76-147</td>
<td>Grade 13</td>
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<tr>
<td>Provide Facilities or Services for Political Campaign Activities</td>
<td>RRs 72-512, 72-513, and 74-574; 1.501(c)(3)-1(c)(3)(iii) of Regulations</td>
<td>Grade 12</td>
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<tr>
<td>Support, Oppose or Rate Political Candidates - extensive use of internet</td>
<td>RRs 74-117, 78-248, 80-282 and 86-95</td>
<td>Grade 13</td>
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<tr>
<td>Voter Education</td>
<td>RRs 78-248 and 86-95</td>
<td>Grade 12</td>
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<tr>
<td>Voter Information on Issues or Candidates</td>
<td>RRs 78-248, 80-282 and 86-95</td>
<td>Grade 12</td>
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<tr>
<td>Voter Registration - 4945(f)</td>
<td>4945(f)</td>
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<tr>
<td><strong>Community Improvement &amp; Capacity Building</strong></td>
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<tr>
<td>Combating Community Deterioration</td>
<td>RRs 68-15, 68-655, and 76-147</td>
<td>Grade 11</td>
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<td>Community Promotion</td>
<td>RRs 65-195, 66-146, 75-286, and 78-84</td>
<td>Grade 11</td>
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<tr>
<td>Community Service Organization</td>
<td>RRs 68-15, 70-79, 75-386, and 81-284</td>
<td>Grade 11</td>
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<td>Crime Prevention</td>
<td>RR 74-246</td>
<td>Grade 11</td>
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<tr>
<td>Economic Development</td>
<td>RRs 70-81, 74-587, 76-419, and 81-138</td>
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<td>Homeowners Association</td>
<td>RRs 72-102, 74-99, and 80-63</td>
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<td>Industry Trade Shows and Conventions</td>
<td>513(d)</td>
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<td>Lessen Neighborhood Tensions</td>
<td>RR 68-438</td>
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<td>Loans or Grants for Minority Business</td>
<td>RRs 74-587 and 81-284</td>
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<tr>
<td>Promotion of Fair Business Practices</td>
<td>RRs 58-294 and 66-223</td>
<td>Grade 11</td>
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<tr>
<td>Title Holding Corporation - 501(c)(2)</td>
<td>RRs 58-566, 68-37, 69-278, 69-381, and 77-72</td>
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<tr>
<td>Title Holding Corporation - 501(c)(25)</td>
<td>2001 CPE</td>
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<tr>
<td><strong>Crime and Legal Related</strong></td>
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<tr>
<td>Legal Aid Society</td>
<td>RRs 69-161 and 78-428</td>
<td>Grade 11</td>
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<td>Prepaid Legal Services Plan - 501(c)(20)</td>
<td>120 and 501(c)(20), 1979 CPE</td>
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<td>Public Interest Law Firms</td>
<td>RRs 75-74, 75-76, and 76-5; Rev. Proc. 92-59</td>
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<tr>
<td>Rehabilitation of Convicts and Exconvicts</td>
<td>RRs 67-150, 73-128, and 75-472</td>
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#### Education

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<th>Code and Regulations</th>
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<td>Alumni Association</td>
<td>RRs 56-486 and 60-143</td>
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<tr>
<td>Booster Clubs</td>
<td>RRs 55-587, 69-538, 70-534 and 71-97</td>
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<td>Charter School Management Company</td>
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<tr>
<td>Charter Schools (Managed by For Profit)</td>
<td>Code and Regulations - exclusively educational</td>
<td>12</td>
</tr>
<tr>
<td>Charter Schools (No For-Profit Management Company)</td>
<td>Code and Regulations - exclusively educational</td>
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<tr>
<td>Cooperative Service Organization - 501(f)</td>
<td>501(f), 1986 CPE article</td>
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<tr>
<td>Faculty Group</td>
<td>RR 68-16</td>
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<tr>
<td>Fraternity or Sorority</td>
<td>RR 69-573</td>
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<tr>
<td>Library</td>
<td>RRs 74-15 and 75-196</td>
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<td>Literacy Activities</td>
<td>RRs 76-384 and 77-68</td>
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<tr>
<td>Private Schools (Mississippi and Louisiana or evidence of related party transactions)</td>
<td>Rev. Proc. 75-50</td>
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<tr>
<td>Private Schools (not Mississippi or Louisiana and no evidence of substantial related party transactions)</td>
<td>Rev. Proc. 75-50</td>
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<tr>
<td>PTOs</td>
<td>RR 68-16</td>
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<td>Scholarships</td>
<td>RRs 66-103, 69-257, 76-47 and 80-39</td>
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<td>School Athletic Association</td>
<td>RRs 55-587 and 67-291</td>
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<tr>
<td>Student Exchange with Foreign Country</td>
<td>RR 69-400</td>
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<tr>
<td>Student Housing</td>
<td>RRs 64-274 and 76-336</td>
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<td>Student Loans and Aid</td>
<td>RRs 66-103 and 69-257</td>
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<tr>
<td>Student Operated Businesses</td>
<td>RRs 73-127, 73-128 and 76-37</td>
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<td>Student Organizations</td>
<td>RRs 56-403 and 73-439</td>
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#### Employment

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<tr>
<th>Activity</th>
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<tr>
<td>Apprentice Training</td>
<td>RR 67-72</td>
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<tr>
<td>Association of Employees</td>
<td>IRM 7.25.4, 1984 CPE, 1.501(c)(4) of Regulations, RRs 70-31 and 82-138</td>
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<tr>
<td>Job Training, Counseling, or Assistance</td>
<td>RRs 67-72 and 73-128</td>
<td>11</td>
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<tr>
<td>Labor Union or Organization - 501(c)(5)</td>
<td>IRM 7.25.5, 2003 CPE, many RRs</td>
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</table>
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<th>Environment</th>
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<tr>
<td>Beautification Activities</td>
<td>RRs 68-14 and 75-286</td>
<td>Grade 11</td>
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<tr>
<td>Carbon / Electric Credits</td>
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<td>Grade 13</td>
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<tr>
<td>Conservation, Environmental Protection, Historical Preservation through Easements and Land Acquisition</td>
<td>RR 76-204</td>
<td>Grade 13</td>
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<tr>
<td>Conservation, Environmental Protection, Historical Preservation (No Easements or Land Acquisitions)</td>
<td>RR 76-204</td>
<td>Grade 12</td>
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<tr>
<td>Educational Conservation and Environmental Activities</td>
<td>RRs 72-560 and 76-204</td>
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<td>Garden Club</td>
<td>RR 66-179</td>
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<th>Food, Agriculture &amp; Nutrition</th>
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<td>Agricultural or Horticultural Organization - 501(c)(5)</td>
<td>IRM 7.25.5, 2003 CPE, RR 56-245, 66-105, 72-391, 73-520, 74-118, 74-195, 74-488, 75-287, 76-399, 81-59, etc.</td>
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<tr>
<td>Farmer's Market</td>
<td>RRs 68-167 and 72-560</td>
<td>Grade 12</td>
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<tr>
<td>Farming Cooperative Marketing or Purchasing – 521</td>
<td>RRs 55-496, 58-483, 67-152, 67-422, 75-388, 76-388, and many others</td>
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<th>Health Care</th>
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<tr>
<td>Abortion Clinic</td>
<td>RRs 69-473, 73-313 and 74-595</td>
<td>Grade 13</td>
</tr>
<tr>
<td>Accountable Care Organizations (ACOs)</td>
<td>No law with clear link to issue</td>
<td>Grade 13</td>
</tr>
<tr>
<td>Blood Banks, Sperm Banks, Milk Banks, etc.</td>
<td>RRs 73-313 and 80-114</td>
<td>Grade 12</td>
</tr>
<tr>
<td>Community Health Planning</td>
<td>RRs 68-15 and 70-79</td>
<td>Grade 11</td>
</tr>
<tr>
<td>Electronic Health Records (EHRs), Regional Health Information Organizations (RHIOs)</td>
<td>No law with clear link to issue</td>
<td>Grade 13</td>
</tr>
<tr>
<td>Family Planning</td>
<td>RR 74-595</td>
<td>Grade 11</td>
</tr>
<tr>
<td>General Health Services</td>
<td>RRs 68-15, 70-590, 70-79, 72-16 and 73-313</td>
<td>Grade 11</td>
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<tr>
<td>Group Medical Practice and In-Faculty Group Practice Association</td>
<td>BHW Anesthesia Foundation Inc. v. Commissioner; Univ of Massachusetts Medical School Group Practice v. Commissioner; Univ. of Maryland Physicians v. Commissioner</td>
<td>Grade 13</td>
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<tr>
<td>Health Clinic and Rural Medical Facility (including Federally Qualified Health Centers)</td>
<td>RRs 70-590, 73-313, and 80-114</td>
<td>Grade 11</td>
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</table>
### Health Care (Continued)

<table>
<thead>
<tr>
<th>Description</th>
<th>Code/Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hospital and some health care clinics per IRM 7.26.2.4.1.1(3).</td>
<td>RR 69-545, 73-131, and 74-619</td>
</tr>
<tr>
<td>Hospital Auxiliary</td>
<td>RR 69-631</td>
</tr>
<tr>
<td>Hospital Pharmacy</td>
<td>RR 68-374, 68-375 and 68-376</td>
</tr>
<tr>
<td>Medical Sharing Plan / Health Care Sharing Ministries (whose members share a common set of ethical or religious beliefs)</td>
<td>No law with clear link to issue</td>
</tr>
<tr>
<td>Mobile Health Units (Mammography, Ultrasounds, Pregnancy Testing, etc.)</td>
<td>RR 69-473 and 74-619</td>
</tr>
<tr>
<td>Nurses Register</td>
<td>RR 69-656 and 61-170</td>
</tr>
<tr>
<td>Other &quot;Hospital&quot; Organizations</td>
<td>RR 69-545</td>
</tr>
<tr>
<td>• Integrated Delivery Systems</td>
<td>N/A - Rev. Proc. has not yet been written</td>
</tr>
<tr>
<td>• HMO's</td>
<td>RR 69-473 and 74-619</td>
</tr>
<tr>
<td>• PPO's</td>
<td>RR 69-473 and 74-619</td>
</tr>
<tr>
<td>• Physician Hospital Organizations</td>
<td>RR 69-473 and 74-619</td>
</tr>
<tr>
<td>• Managed Care Purchasing Organizations</td>
<td>RR 69-473 and 74-619</td>
</tr>
<tr>
<td>Hospital Pharmacy RRs 68-374, 68-375 and 68-376 Grade 13</td>
<td>RR 69-545</td>
</tr>
<tr>
<td>Medical Sharing Plan / Health Care Sharing Ministries (whose members share a common set of ethical or religious beliefs)</td>
<td>No law with clear link to issue</td>
</tr>
<tr>
<td>Mobile Health Units (Mammography, Ultrasounds, Pregnancy Testing, etc.)</td>
<td>RR 69-473 and 74-619</td>
</tr>
<tr>
<td>Nurses Register</td>
<td>RR 69-656 and 61-170</td>
</tr>
<tr>
<td>Other &quot;Hospital&quot; Organizations</td>
<td>RR 69-545</td>
</tr>
<tr>
<td>• Integrated Delivery Systems</td>
<td>N/A - Rev. Proc. has not yet been written</td>
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<td>• HMO's</td>
<td>RR 69-473 and 74-619</td>
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<tr>
<td>• PPO's</td>
<td>RR 69-473 and 74-619</td>
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<tr>
<td>• Physician Hospital Organizations</td>
<td>RR 69-473 and 74-619</td>
</tr>
<tr>
<td>• Managed Care Purchasing Organizations</td>
<td>RR 69-473 and 74-619</td>
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<tr>
<td>Qualified Non-Profit Heath Insurance Issuers - 501(c)(29)</td>
<td>N/A - Rev. Proc. has not yet been written</td>
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<tr>
<td>Rescue and Emergency Services</td>
<td>RR 74-246 and 74-361</td>
</tr>
<tr>
<td>Skilled Nursing Facility</td>
<td>RR 70-585</td>
</tr>
<tr>
<td>State Sponsored High Risk Insurance - 501(c)(26)</td>
<td>RR 69-631</td>
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<tr>
<td>State Sponsored Workers Compensation - 501(c)(27)</td>
<td>RR 69-631</td>
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### Housing & Shelter

<table>
<thead>
<tr>
<th>Description</th>
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<tbody>
<tr>
<td>Down Payment Assistance</td>
<td>RR 2006-27</td>
</tr>
<tr>
<td>Housing for the Elderly or Disabled</td>
<td>RR 72-124, 79-18 and 79-19</td>
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<tr>
<td>Instruction and Guidance on Housing</td>
<td>RR 67-138 and 69-441</td>
</tr>
<tr>
<td>Low and Moderate Income Housing</td>
<td>RR 70-585</td>
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<tr>
<td>Other Housing Activities (Transitional, Temporary, etc.)</td>
<td>RR 75-472</td>
</tr>
<tr>
<td>Student Housing</td>
<td>RR 64-274 and 76-336</td>
</tr>
<tr>
<td>Foreclosed Home - Acquisition, Rent or Sales</td>
<td>RR 70-585</td>
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</table>
## Human Services

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<tr>
<th>Activity</th>
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</thead>
<tbody>
<tr>
<td>Credit Counseling - Credit Repair, Debt Management Plans or Bankruptcy Counseling, or Substantial Financial Literacy</td>
<td>501(q); CCCS of Alabama v. US; CCCS of Oklahoma, Inc. v. US</td>
<td>13</td>
</tr>
<tr>
<td>Day Care Center</td>
<td>501(k); RR 68-166</td>
<td>11</td>
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<tr>
<td>Foreclosure Assistance</td>
<td>501(q)</td>
<td>13</td>
</tr>
<tr>
<td>Gifts, Grants or Loans to Individuals (other than scholarships)</td>
<td>RR 56-304 and 66-103</td>
<td>11</td>
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<tr>
<td>Referral Service (Social Agencies)</td>
<td>RR 75-198</td>
<td>11</td>
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<tr>
<td>Services for the Elderly or Disabled</td>
<td>RR 76-244 (Elderly) and 77-68 (Disabled)</td>
<td>11</td>
</tr>
<tr>
<td>Thrift Shop, Retail Outlet, etc.</td>
<td>RR 71-581 and 80-106</td>
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</table>

### International, Foreign Affairs & National Security

<table>
<thead>
<tr>
<th>Activity</th>
<th>Code/Rules</th>
<th>Grade</th>
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</thead>
<tbody>
<tr>
<td>Foreign Organization (includes organizations formed in U.S. Territories)</td>
<td>RR 68-165</td>
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<tr>
<td>Foreign Conduits</td>
<td>RR 63-252 and 66-79</td>
<td>13</td>
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### Mental Health & Crisis Intervention

<table>
<thead>
<tr>
<th>Activity</th>
<th>Code/Rules</th>
<th>Grade</th>
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</thead>
<tbody>
<tr>
<td>Counseling</td>
<td>RR 67-72, 69-441, 70-640 and 73-128</td>
<td>11</td>
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<tr>
<td>Mental Health Care</td>
<td>RR 72-209 and 73-313</td>
<td>11</td>
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<tr>
<td>Rehabilitating Alcoholics, Drug Abusers, Compulsive Gamblers, etc.</td>
<td>RR 75-472</td>
<td>11</td>
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</table>

### Mutual & Membership Benefit

<table>
<thead>
<tr>
<th>Activity</th>
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<tbody>
<tr>
<td>Assigned Risk Insurance Activities</td>
<td>RR 74-196</td>
<td>13</td>
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<tr>
<td>Cemetery or Burial Activities</td>
<td>RR 61-137, 64-109, 65-6, 69-637, 71-300, 72-17, 77-70, and 78-143</td>
<td>11</td>
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<tr>
<td>Fraternal Beneficiary Society, Order or Association - 501(c)(8) or 501(c)(10)</td>
<td>IRM 7.25.8, 1980 and 2004 CPE, many RRs</td>
<td>11</td>
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<tr>
<td>Health Insurance and Prepaid Group Health Plan</td>
<td>RR 74-196</td>
<td>13</td>
</tr>
<tr>
<td>Perpetual Care Fund</td>
<td>RR 61-137, 64-217, 65-6, 69-256, and 78-143</td>
<td>11</td>
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<tr>
<td>Supplemental Unemployment Benefit Plan (SUB) - 501(c)(17)</td>
<td>RR 70-188, 70-189, 70-536, 71-156, 73-307, 77-43 and 81-68</td>
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<tr>
<td>Underwriting Municipal Insurance</td>
<td>RR 74-196</td>
<td>13</td>
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<tr>
<td>Voluntary Employee Beneficiary Association (VEBA) - 501(c)(9)</td>
<td>IRM 7.25.9; Rev. Proc. 82-46; RR 66-212 and 85-199</td>
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### Philanthropy, Volunteerism & Grantmaking Foundations

<table>
<thead>
<tr>
<th>Activity</th>
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<th>Grade</th>
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<tbody>
<tr>
<td>4940(d) Exempt Operating Foundation</td>
<td>4940(d)</td>
<td>13</td>
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<tr>
<td>4942(g) set-asides</td>
<td>RR 74-560, 75-511 and 80-97</td>
<td>13</td>
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<tr>
<td>4945(g)</td>
<td>RR’s 77-380, 77-434, 81-46, 81-293 and many others</td>
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<tr>
<td>Community Chest, [D] (3) (A) etc.</td>
<td>RR 67-325</td>
<td>11</td>
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<tr>
<td>Community Trust or Component</td>
<td>RR 60-384</td>
<td>11</td>
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<tr>
<td>Donor Advised Funds</td>
<td></td>
<td>12</td>
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<tr>
<td>Endowment Fund or Financial Services</td>
<td>RR 69-528</td>
<td>12</td>
</tr>
<tr>
<td>Fundraising as Primary Activity - conducted solely via the internet (auction or professional fundraising arrangement)</td>
<td>1989 CPE Article, RR's 64-182 and 67-246</td>
<td>13</td>
</tr>
<tr>
<td>Fundraising - Athletic or Sports Event (golf tournament)</td>
<td>RR 67-149</td>
<td>11</td>
</tr>
<tr>
<td>Gifts, Grants, Loans, Facilities to other Organizations</td>
<td>RR's 67-149, 68-489, 71-413, etc.</td>
<td>11</td>
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<tr>
<td>Investments in Hedge Funds</td>
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### Public & Societal Benefit

<table>
<thead>
<tr>
<th>Activity</th>
<th>Reference</th>
<th>Grade</th>
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</thead>
<tbody>
<tr>
<td>Consumer Interest Group</td>
<td>RR 78-50</td>
<td>12</td>
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<tr>
<td>Credit Union - 501(c)(14)</td>
<td>RR's 69-282, 69-283, 72-37 and 83-166</td>
<td>13</td>
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<tr>
<td>Erection or Maintenance of Public Building or Works</td>
<td>RR's 59-310, 66-358, 70-186, 75-470, and 86-49</td>
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<tr>
<td>Federal Instrumentality - 501(c)(1)</td>
<td>RR's 55-319, 60-384, and 74-14</td>
<td>13</td>
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<tr>
<td>Mutual Ditch, Irrigation, Telephone, Electric Co., or Like Organization - 501(c)(12)</td>
<td>IRM 4.76.20; IRM 7.25.12; RR's 72-36, 2002-54, 2002-55, etc.</td>
<td>11</td>
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<tr>
<td>Reserve Funds or Insurance for Domestic Building and Loan Assoc., Cooperative Bank, or Mutual Savings Bank - 501(c)(14)</td>
<td>RR's 69-282, 69-283, 72-37 and 83-166</td>
<td>13</td>
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<tr>
<td>State or Local Instrumentality</td>
<td>RR's 55-319, 60-384 and 74-14</td>
<td>13</td>
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<tr>
<td>Veterans Activities</td>
<td>RR's 58-517, 66-150, 68-45, 68-46, 68-455, and 78-239</td>
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<td><strong>Public Safety, Disaster Preparedness &amp; Relief</strong></td>
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<tr>
<td>Emergency or Disaster Aid Fund</td>
<td>RRs 69-174, 71-99, and 77-3</td>
<td>Grade 11</td>
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<tr>
<td>Testing Products for Public Safety</td>
<td>RRs 65-61 and 78-426</td>
<td>Grade 12</td>
</tr>
<tr>
<td>Voluntary Firemen's Org. or Auxiliary</td>
<td>RRs 71-47, 74-361, and 87-126</td>
<td>Grade 11</td>
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**Recreation & Sports**

| **Amateur Athletic Organization - adult education or recreation in a sport** | RR 77-365; Hutchinson Baseball Enterprises, Inc. v. Commissioner; Media Sports League, Inc. v. Commissioner | Grade 11 |
| **Community Center or Recreation Facility** | RRs 57-493, 59-310, 67-109 and 79-167 | Grade 11 |
| **Fostering National or International Sports Competition - 501(j)** | 501(j); RR 64-275 | Grade 11 |
| **Hobby Clubs and Social Clubs** | RRs 66-179, 66-273 and 67-142 | Grade 11 |
| **Professional Athletic Team** | Hutchinson Baseball Enterprises, Inc. v. Commissioner and Media Sports League, Inc. v. Commissioner | Grade 13 |
| **Social Clubs - Activity conducted solely via internet** | | Grade 13 |
| **Youth Sports** | RRs 65-2 and 80-215 | Grade 11 |

**Religion-Related**

| **Association of Churches** | RR 74-224 | Grade 11 |
| **Church** | American Guidance Foundation v. Commissioner | Grade 11 |
| **Church Auxiliary** | RR 77-381 | Grade 11 |
| **Evangelism** | RR 75-434 | Grade 11 |
| **Missions and Missionary Activities** | RR 75-434 | Grade 11 |
| **Non-Traditional Church – activities conducted solely via internet** | American Guidance Foundation v. Commissioner | Grade 13 |
| **Other Religious Activities** | RRs 68-72 and 77-430 | Grade 11 |
| **Religious Order - 501(d)** | 501(d) | Grade 12 |
| **Religious Publishing Organizations** | RRs 68-306 and 68-563 | Grade 11 |

**Research**

| **Medical Research** | RRs 69-632 and 71-506 | Grade 13 |
| **Research, Development and Testing for an Industry** | | Grade 12 |
| **Scientific Research** | RRs 69-632 and 71-506 | Grade 13 |
| **Study and Research Groups (non-scientific)** | RRs 70-129 and 80-301 | Grade 11 |
### Exhibit 6-3

#### Sample EO Determination Case Assignment Guide, Summary Application of Tax Law

<table>
<thead>
<tr>
<th>Youth Development</th>
<th>Miscellaneous</th>
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<tbody>
<tr>
<td>![Image]</td>
<td>![Image]</td>
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</tbody>
</table>

#### Youth Development

- **509(a)(3) – Abusive**
  - RR 74-229, 76-32, 76-208, 79-197, 80-207 and 81-43
  - Grade 13
- **509(a)(3) - Type III (including Reclassifications)**
  - RR 74-229, 76-32, 76-208, 79-197, 80-207 and 81-43
  - Grade 13
- **990 Filing Exemption**
  - Rev. Proc. 95-48 and Regs. 1.6033-2(h)
  - Grade 11
- **Consulting Services**
  - RR 68-225, 71-529 and 72-369
  - Grade 12
- **For-Profit Related (including successor)**
  - Church by Mail Inc. v. Commissioner; est of Hawaii v. Commissioner
  - Grade 12
- **Foundation Follow-up Cases**
  - Grade 11
- **Gaming (primary activity)**
  - Announcement 89-138; Make a Joyful Noise Inc. v. Commissioner; PLL Scholarship Fund v. Commissioner
  - Grade 12
- **Group Ruling**
  - Rev. Proc. 80-27
  - Grade 12
- **Indian Tribal Governments or Cultural Activities**
  - RR 77-272; Revenue Procedures 83-87, 84-36 and 84-37
  - Grade 12
- **Internet Service Provider**
  - Grade 13
- **Lessening the Burdens of Government**
  - RR 85-1 and 85-2
  - Grade 12
- **Limited Liability Corporations - Operational Test**
  - 2000 and 2001 CPE
  - Grade 12
- **Limited Liability Corporations - Organizational Test**
  - 2000 and 2001 CPE
  - Grade 11
- **New Markets Tax Credit**
  - 45D, Regs. 1.45D-1(e) and you can visit [http://www.cdfifund.gov/](http://www.cdfifund.gov/) for information.
  - Grade 12
- **Potential Terrorism, Fraud or Abusive Schemes**
  - Fraud Training Material
  - Grade 12
- **Previously Revoked Organizations (does not include auto revoked)**
  - Grade 13
- **Professional Fundraiser**
  - Grade 12
- **Terminations of PF Status**
  - Grade 11

#### Miscellaneous

- **Note:** this section includes specific "problems" present in cases, rather than the applicant's purpose. If an applicant exhibits one of these issues, the grade shown here will take precedence over a lower grade shown elsewhere on the CAG.

- **509(a)(3) – Abusive**
  - RR 74-229, 76-32, 76-208, 79-197, 80-207 and 81-43
  - Grade 13
- **509(a)(3) - Type III (including Reclassifications)**
  - RR 74-229, 76-32, 76-208, 79-197, 80-207 and 81-43
  - Grade 13
- **990 Filing Exemption**
  - Rev. Proc. 95-48 and Regs. 1.6033-2(h)
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  - Grade 13
- **Professional Fundraiser**
  - Grade 12
- **Terminations of PF Status**
  - Grade 11
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# User Fee Refund Request

<table>
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<tr>
<th>Date:</th>
<th>Organization Name:</th>
<th>EIN:</th>
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## Reason for Refund *(check only one box):*

- [ ] Receipts average less than $10,000
- [ ] IRS error
- [ ] Applicant simply paid wrong dollar amount
- [ ] Applicant already exempt
- [ ] Paid group exemption in error
- [ ] Higher fee required (organization doesn’t want to pay/pursue exemption)
- [ ] Applicant covered by group ruling
- [ ] Group ruling declination
- [ ] Other (explain):

## Refund Amount:

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<thead>
<tr>
<th>Amount Paid:</th>
<th>Amount Due:</th>
<th>Total Refund:</th>
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## From

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<tr>
<td>Room Number:</td>
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## Approval of Refund Request:

<table>
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<tr>
<th>Date:</th>
<th>Group Manager Signature:</th>
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Chapter 7

Introduction to the Form 1023 Application and Overview of Screening

Instructor Preparation

Estimated Time 3 hours

Reference Materials

- Instructor Guide, Chapter 7, Introduction to the Form 1023 Application and Overview of Screening
- Student Guide, Chapter 7, Introduction to the Form 1023 Application and Overview of Screening
- Exhibit 7-1, AP/71 Technical Screening Development Checksheet
- Exhibit 7-2, IP/71 Technical Screening Development Checksheet
- Exhibit 7-3, Exempt Organizations (EDS / TEDS) Technical Screening Checksheet

Training Aids TA 7-1, Objectives

Notes to Instructor Create a flip chart of the Objectives to display throughout the chapter, or create a transparency using TA 7-1.
Chapter 7
Objectives

After completing this chapter you will be able to:

• Identify the parts of Form 1023 and the information contained in each part

• Name the schedules that supplement Form 1023

• Describe how cases are screened

• Document actions on a case

• Identify the workpapers required in a case
Chapter 7
Introduction to the Form 1023 Application and Overview of Screening

Overview

Introduction

Organizations seeking recognition of exemption from Federal income tax under section 501(c)(3) of the Code must apply on Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. Form 1023 will be the primary focus of this chapter. Details of the Form 1024, Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120, will be provided Unit 1b.

An early and critical step in the processing of an application is when it is reviewed by the Technical Screening Group. An overview of the technical screening process will be discussed in this chapter.

Once a case is assigned to a specialist after being screened, one of the most important aspects of working the case will be documentation and how that documentation is assembled in the file before closure. This chapter will also review some of the requirements for documentation -- often called “work papers.”

Continued on next page
Overview, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Display and discuss the Objectives, or a review, on the flip chart.</td>
</tr>
</tbody>
</table>

**Objectives**

After completing this chapter you will be able to:

- Identify the parts of Form 1023 and the information contained in each part
- Name the schedules that supplement Form 1023
- Describe how cases are screened
- Document actions on a case
- Identify the work papers required in a case

**In This Chapter**

This chapter contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
<td>1</td>
</tr>
<tr>
<td>Exempt Organization Applications</td>
<td>3</td>
</tr>
<tr>
<td>Form 1023</td>
<td>5</td>
</tr>
<tr>
<td>Screening Applications</td>
<td>14</td>
</tr>
<tr>
<td>Summary</td>
<td>17</td>
</tr>
<tr>
<td>Exhibit 7-1: AP/71 Technical Screening Development Checksheet</td>
<td>19</td>
</tr>
<tr>
<td>Exhibit 7-2: IP/71 Technical Screening Development Checksheet</td>
<td>21</td>
</tr>
<tr>
<td>Exhibit 7-3: Exempt Organizations (EDS / TEDS) Technical Screening Checksheet</td>
<td>23</td>
</tr>
</tbody>
</table>
Exempt Organization Applications

The following forms are currently used to apply for exemption from Federal income tax:

- **Form 1023**, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*

  Applicants must use this form to apply for exemption under IRC section 501(c)(3).

- **Form 1024**, *Application for Recognition of Exemption Under Section 501(a)*

  Applicants use this form to apply for exemption under IRC sections 501(c) (2), (4), (5), (6), (7), (8), (9), (10), (12), (13), (15), (17), (19), and (25).

**Form 1025**

This is a “dummy” form number. There is no actual Form 1025. It is used to establish applications on the EDS system under the following IRC sections: 501(c)(1), (11), (14), (16), (18), (21), (22), and 501(d) or 4947(a), (27), and 529. These organizations apply by letter.

**Form 1026**

This is also a “dummy” form number. There is no actual Form 1026. It is used to establish applications for group exemption on the EDS system.

- **Form 1028**, *Application for Recognition of Exemption Under Section 521 of the Internal Revenue Code*

  This application is used by farmers, fruit growers, or similar cooperative associations that claim exemption under IRC section 521.

(See IRM 7.25.1)

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Continued on next page
Exempt Organization Applications, Continued

Instructor Notes

Explain that Rev. Proc. 2012-9 specifies the criteria for a “complete” application. It may be good practice to have them look up the Rev. Proc. and find the applicable section describing these requirements.

"Complete" Application

Generally, an application is complete if the following items are provided:

- The correct user fee (including Form 8718 for organization’s applying on Form 1024)
- The following signed by an authorized person:
  - The application form
  - Form 2848/8821, if applicable
- An employer identification number (EIN) – This is assigned before the case is received by EO Determinations
- All applicable pages and schedules of Form 1023/1024
- A conformed organizing document
- Bylaws, if adopted
- Applicable financial information
- A description of the organization’s activities

(See IRM 7.20.2.4 (2))
Form 1023

Introduction

Organizations applying for exemption under section 501(c)(3) of the Code complete Form 1023. In the year 2006 a revised Form 1023 was put into use.

Approximately 90% of the applications received are on Form 1023.

The Form 1023 is divided into the following eleven parts:

- **Part I** – Identification of Applicant
- **Part II** – Organizational Structure
- **Part III** – Required Provisions in Your Organizing Document
- **Part IV** – Narrative Description of Your Activities
- **Part V** – Compensation and Other Financial Arrangements With Your Officers, Directors, Trustees, Employees, and Independent Contractors
- **Part VI** – You Members and Other Individuals and Organizations That Receive Benefits From You
- **Part VII** – Your History
- **Part VIII** – Your Specific Activities
- **Part IX** – Financial Data
- **Part X** – Public Charity Status
- **Part XI** – User Fee Information

**Schedules A through H**

**Form 1023 Checklist**

Questions on the application are, for the most part, yes/no questions. If the organization answers “yes,” then they are required to attach an explanation.

Each part will be discussed in this chapter.

Continued on next page
Part I, Identification of Applicant, includes the following information:

- The organization’s full name and address
  The name should match that shown on the organization’s organizing document (Constitution or Articles of Association).

- Employer Identification Number (EIN)

- Month the annual accounting period ends
  The month provided should be consistent with the fiscal month provided in the organization’s bylaws and the fiscal month used in the organization’s financial data.

- Primary contact
  The contact person should be an officer, director, trustee, or authorized representative.

- Authorized representative
  The authorized representative should be listed on Form 2848.

- Paid preparer
  The name, address, and amounts paid to that person are identified.

- Web site address and e-mail address

- Is the organization required to file Form 990 or 990 EZ?

- Date Formed
  If incorporated, the formation date is the actual date the Articles of Incorporation were filed and approved by the State in which the organization is incorporated.
  If not incorporated, the formation date is the actual date the organization’s organizing document was adopted.

- Formed in a foreign country?

The information in this part tells us general identifying information about the applicant. Form 2848 is Power of Attorney and Declaration of Representative and Form 990 is a Return of Organization Exempt From Tax.
Part II, *Organization Structure*, includes the following information:

- Is the organization a corporation?
- Is the organization a Limited Liability Company (LLC)?
  All members of a 501(c)(3) organization that is formed as an LLC must be 501(c)(3) organizations.
- Is the organization an unincorporated association?
- Is the organization a trust?
- Has the organization adopted bylaws?
- Bylaws are not required; however, if the organization operates under bylaws, they must be submitted along with the application.

Information in this part tells us how the organization is legally formed.

Part III, *Required Provisions in Your Organizing Document*, includes the following information:

- Does the organizing document contain a proper purpose clause?
- Does the organizing document contain a proper dissolution provision?

Information in this part is used to determine whether the organization will meet the organizational test under section 501(c)(3) of the Code.

Part IV, *Narrative Description of Your Activities*, includes the following information:

- A narrative description of past, present, and planned activities

This part gives the organization the opportunity to tell us, in narrative form, what they are doing.
Part V, Compensation and Other Financial Arrangements with Your Officers, Directors, Trustees, Employees, and Independent Contractors, includes the following information:

- Names, titles, addresses, and compensation amounts of officers, directors and trustees
- Names, titles, addresses, and compensation amounts of each of the five highest compensated employees who receive over $50,000
- Names, names of businesses, and addresses of the highest compensated independent contractors, and the compensation amounts
- Relationships of officers, directors, and trustees, employees, and independent contractors
- Qualifications, hours worked, and duties of officers, directors, trustees, highest compensated employees, and highest compensated independent contractors
- Does the organization have a conflict of interest policy?
- Leases, loans, contracts with officers, directors, trustees, highest compensated employees, and highest paid independent contracts
- How were the terms negotiated? Arm’s length?

The information in this part is analyzed to determine potential private benefit and inurement.

Continued on next page
Form 1023, Continued

Part VI

Part VI, *Your Members and Other Individuals and Organizations that Receive Benefits from You*, includes the following information:

- Does the organization provide goods, services, or funds to individuals or organizations?
- Do programs limit goods, services, or funds to a specific individual or group of specific individuals?
- Relationships between recipients and officers, directors, trustee, or highest paid employees or independent contract?

The information in this part is analyzed to determine who is receiving benefits and the potential for private benefit and inurement.

Part VII

Part VII, *Your History*, includes the following information:

- Is the organization a successor to another organization? If so, the organization is instructed to complete Schedule G.
- Is the organization submitting Form 1023 more than 27 months after the end of the month in which they were legally formed?
- Section 508 of the Code requires that organizations submit applications within 15 months of the date of formation. Rev. Proc. 92-85, grants an automatic 12-month extension.

If the application is being submitted after 27 months, the organization is directed to complete Schedule E.

Continued on next page
Part VIII

Part VIII, *Your Specific Activities*, includes the following information:

- Support or oppose political candidates
- Attempt to influence legislation
- Form 5768 may be submitted with Form 1023
- Operate bingo or gaming
- Who conducts? Revenue and expenses? Contracts and Agreements? Where?
- Fundraising
- How? Written or oral contracts? For other organizations? Where? Donor-advised?
- Affiliated with a governmental unit?
- Engage in Economic Development?
- Who will develop and manage facilities and what, if any, is their relationship to officers, directors and trustees?
- Does the organization participate in joint ventures?
- Is the organization a providing childcare?
- Publish, own, or have rights in intellectual property?
- Accept contributions of real property, conservation easements, closely held securities, or intellectual properties?
- Operate in a foreign country?
- Grants, loans, or other distributions to organizations?
- Grants, loans, or other distributions to foreign organizations?
- Close connection with any organizations?

*Continued on next page*
Form 1023, Continued

Part VIII (continued)

- Cooperative hospital service organization?
- Cooperative Service organization of operating educations organization?
- Charitable risk pool?
- Operate a school?
  If so, the organization is directed to complete Schedule B.
- Provide hospital or medical care?
  If so, the organization is directed to complete Schedule C.
- Low income housing or housing for the elderly or handicapped?
  If so, the organization is directed to complete Schedule F.
- Scholarships, fellowships, educational loans, or other educational grants to individuals?
  If so, the organization is directed to complete Schedule H.

Information in this part is used to determine whether the organization will meet the operational test for exemption under section 501(c)(3) of the Code.

Part IX

Part IX, Financial Data, includes the following:

- Statement of Revenue and Expenses
- Balance Sheet
- Includes assets and liabilities

The information in this part is used to determine the financial status of the organization and to determine if the expenditures are being used to achieve the organization’s exempt purposes.

Continued on next page
Form 1023, Continued

Part X

Part X, Public Charity Status, includes the following information:

- Private foundation?
- Private operating foundation?
- Public charity?
- Church? School? Hospital? Supporting organization? Testing for public safety? For the benefit of a college or university? Publicly supported?
- Support test information for public charities in existence for at least five years and granted relief from the timely filing requirement
- Unusual grants?

Every organization that is exempt under section 501(c)(3) is a private foundation unless they can establish that they meet a public charity status. This section is used to determine whether the organization is a private foundation or a public charity.

Part XI

Part XI, User Fee Information, includes the following information:

- User fee payment of $300?
- User fee payment of $750?
  This information is used in conjunction with the activities of the organization and the financial information submitted, to determine that the organization paid the correct user fee for the processing of their application.
- Signature
  The application must be signed by an officer, director, trustee, or other authorized official of the organization. It may not be signed by a designated power of attorney.

Continued on next page
Form 1023, Continued

Form 1023 Schedules & Checklist

Form 1023 is supplemented by the following schedules:

- **Schedule A** - Churches
- **Schedule B** - Schools, Colleges, and Universities
- **Schedule C** - Hospitals and Medical Research Organizations
- **Schedule D** - 509(a)(3) Supporting Organizations
- **Schedule E** - Organizations Not Filing Form 1023 Within 27 Months of Formation
- **Schedule F** - Homes for the Aged or Handicapped and Low-Income Housing
- **Schedule G** - Successors to Other Organizations
- **Schedule H** - Organizations Providing Scholarships, Fellowships, Educational Loans, or Other Educational Grants to Individuals and Private Foundations Requesting Advance Approval of Individual Grant Procedures

- **Form 1023 Checklist** - Applicants must complete and submit the Checklist with their application or risk having the application returned.
Screening Applications

**Instructor Notes**
Explain that typically Grade 12s and 13s screen applications, but that Grade 11s may participate in the Accelerated Processing of screening cases.

**Introduction**
Technical screening is a process where EO Determinations specialists quickly review application requests to determine if they can be approved or closed on merit based on the information submitted or if they require additional development. The specialists who perform this initial review of cases are referred to as "screeners." Screeners use sound reasoning based on training and experience to determine if the information in the application meets the organizational, operational, and other technical requirements of the Code and regulations.

Provided below is a brief discussion of the various steps included in the screening process.

**NOTE:** This section provides you a high level overview of how cases are assigned, screened, and processed. Screening is done by experienced specialists and is governed by Screening Procedures. Therefore, your instructors will not discuss case screening procedures in depth.

**Case Assignment**
Chapter 1 includes a flowchart that illustrates how cases are established on EDS and TEDS at the Cincinnati Submission and Processing Center (CSPC) and shipped to the Centralized Files Unit in Cincinnati. From TEDS or the Files Unit, cases are assigned to screeners for technical screening. Our organizational goal is to assign cases to screeners within 14 days of receipt at CSPC.

**Instructor Notes**
Exhibit 7-1 – Explain that the CAG is an evolving mechanism and categories may be revised at any time.

**Assigning Case Grades**
Cases are assigned case grades based on the activities of the organization or issues present in the case. Using the Case Assignment Guide (CAG), the screener is responsible for assigning the proper case grade. The screener indicates the grade level of the case on the EO Determination Input Sheet or case label.

Continued on next page
<table>
<thead>
<tr>
<th><strong>Screening Applications, Continued</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transferring Cases to EO Technical</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Instructor Notes</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Exhibit 7-2 – show students the AP/71 Technical Screen Development Checksheet.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Accelerated Processing</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Screeners determine whether a case may be worked as an Accelerated Processing case. Accelerated Processing (AP) is a process for cases that require administrative correction(s) in order to be approved on merit.</td>
</tr>
</tbody>
</table>

The screener identifies the needed information on the AP/71 Technical Screening Development Checksheet (see Exhibit 7-1) and the case is assigned to an Accelerated Processing (AP) specialist. Once the information is secured through by the AP specialist, the case is closed on merit.

<table>
<thead>
<tr>
<th><strong>Intermediate Processing</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Screeners also determine whether a case may be worked as an Intermediate Processing case. Intermediate Processing (IP) is a process for cases that require clarification of technical issues and may also require minor procedural items in order to be approved on merit.</td>
</tr>
</tbody>
</table>

The screener identifies the needed information on the IP/71 Technical Screening Development Checksheet (see Exhibit 7-2) and the case is assigned to an Intermediate Processing (IP) specialist. Once the information is secured by the IP specialist, the case is closed on merit.

*Continued on next page*
## Screening Applications, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Exhibit 7-3 – show students the Exempt Organizations Technical Screening Checksheet.</th>
</tr>
</thead>
</table>

### Unassigned Inventory - Development Necessary

If the application requires case development, the screener completes an Exempt Organizations (EDS / TEDS) Technical Screening Checksheet (see Exhibit 7-3) identifying issues for development and places it in the case file.

The case is updated to status 51 in EDS and sent to the Centralized Files Unit for placement in Unassigned Inventory. Cases are assigned for development to determinations specialists in control date order.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>The text references “06” screening merit closures. This may be the time to mention that AP and IP cases are closed in “09” status.</th>
</tr>
</thead>
</table>

### Merit Closures

If the application is "complete" and the organization meets applicable tax law, then the case can be closed on merit. The screener will complete appropriate case closing documents. Case closing documents and procedures are discussed in depth in Chapter 18, Case Closing.

Screening cases are closed status "06" on EDS.

| IRM 7.20.2.3 | See IRM 7.20.2.3 - Technical Screening for additional information regarding Technical Screening. |
Summary

The forms currently used to apply for exemption from Federal income tax are the Form 1023, Form 1024, Form 1025, Form 1026, and Form 1028. Forms 1023 and 1024 are the primary forms that determinations specialists review.

Organizations seeking recognition of exemption from Federal income tax under section 501(c)(3) of the Code must apply on Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. Approximately 90% of the applications received are on Form 1023.

Technical screening is a process where experienced EO Determinations specialists quickly review application requests to determine whether they can be approved or closed on merit based on the information submitted or whether they require additional development.
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# Exhibit 7-1

**EO Determinations**  
**Accelerated Processing Checksheet – Form 1023 Cases**

<table>
<thead>
<tr>
<th>Screener Name:</th>
<th>Date:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organization Name:</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Please contact the applicant for the following information**

<table>
<thead>
<tr>
<th>Articles of Incorporation (A/I)</th>
<th>2</th>
<th>Missing</th>
<th>3</th>
<th>Filed Copy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amendment</td>
<td>4</td>
<td>Amend the Articles to include a dissolution and purpose clause</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Purpose</td>
<td>6</td>
<td>Dissolution</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Organizing Document (Association)</th>
<th>7</th>
<th>Missing</th>
<th>8</th>
<th>Declaration (Date/Signatures) <strong>INSERT</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amend Organizing Document</td>
<td>10</td>
<td>Purpose</td>
<td>11</td>
<td>Dissolution</td>
</tr>
</tbody>
</table>

| Bylaws                           | 12 | Missing |
|                                  | |||

| User Fee Issues                  |
|----------------------------------|---|---------|---|-----------------|
| 13 | Additional payment due |

<table>
<thead>
<tr>
<th>Signature Missing on page 12</th>
<th>14</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>15</td>
<td>Not signed by a board member</td>
<td></td>
</tr>
</tbody>
</table>

| Financial Information            |
|----------------------------------|---|---------|---|-----------------|
| 16 | Need projected budgets for the first three years |
| 17 | Need actual revenue and expenses for the last three years |

<table>
<thead>
<tr>
<th>FYM discrepancy</th>
<th>18</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>19</td>
<td>Names, addresses, and titles of officers or directors</td>
<td></td>
</tr>
</tbody>
</table>

---

**Accelerated Processing Checksheet**

<table>
<thead>
<tr>
<th>Screener's Name:</th>
<th>Date:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Name of Organization:</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Please contact the applicant for the following information**

<table>
<thead>
<tr>
<th>Articles of Incorporation (A/I)</th>
<th>2</th>
<th>Missing</th>
<th>3</th>
<th>Filed Copy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amendment</td>
<td>4</td>
<td>Amend the Articles to include a dissolution and purpose clause</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Purpose</td>
<td>6</td>
<td>Dissolution</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Purpose &amp; Dissolution</th>
<th>10</th>
<th>Purpose</th>
<th>11</th>
<th>Dissolution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>9</td>
<td>BOTH</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

IRS 01329
<table>
<thead>
<tr>
<th>Item</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organizing Document (Association)</td>
<td>Missing Declaration (Date/Signatures)</td>
</tr>
<tr>
<td>Amend Organizing Document</td>
<td>Purpose &amp; Dissolution</td>
</tr>
<tr>
<td></td>
<td>Dissolution</td>
</tr>
<tr>
<td>Trust</td>
<td>Missing Date of Funding</td>
</tr>
<tr>
<td>Bylaws</td>
<td>Missing</td>
</tr>
<tr>
<td>Foundation status</td>
<td>509(a)(1) to 509(a)(2)</td>
</tr>
<tr>
<td></td>
<td>PF, POF, 509(a)(3) to 509(a)(1) 509(a)(2)</td>
</tr>
<tr>
<td></td>
<td>Other</td>
</tr>
<tr>
<td>Definitive Ruling</td>
<td>509(a)(1) 509(a)(2)</td>
</tr>
<tr>
<td></td>
<td>Support test – page 11, part 6b</td>
</tr>
<tr>
<td>User Fee Issues</td>
<td>Additional payment due</td>
</tr>
<tr>
<td></td>
<td>Refund</td>
</tr>
<tr>
<td>Signature</td>
<td>F1023/1024</td>
</tr>
<tr>
<td>Financial Information</td>
<td></td>
</tr>
<tr>
<td>FYM Discrepancy</td>
<td></td>
</tr>
</tbody>
</table>
# EO Determinations Checklist
## Cases Requiring Intermediate Processing

<table>
<thead>
<tr>
<th>Screener Name:</th>
<th>Date:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organization Name:</td>
<td>Case Grade:</td>
</tr>
<tr>
<td></td>
<td>11</td>
</tr>
</tbody>
</table>

Unable to close case on merit. Screen to IP group for the reason(s) checked below.

- Activities □
- Board □
- Effective date of exemption must be clarified □
- Excessive legislative and/or political activities needs to be reviewed □
- Financial □
- For-profit relationship needs to be explored (this includes successors, related, and/or involvement) □
- Foreign operations (check for possible terrorist countries, conduits, expenditure responsibility and/or related foreign for-profit entities) □
- Foundation status needs to be reviewed □
- Organizational document □
  - Missing □
  - Not filed □
- Does not meet org test – need amendment for □
  - Click for options □
- Private benefit and/or inurement possible □
- Private Operating Foundation (claiming POF, but is probably a public charity) □
  - Schedule(s) □
  - Signature missing on page □
  - User fee needs to be clarified □
  - Other □

**TEDS Processing:**

1. Go to Menu – Click on blue button next to Case Information, click on the edit button in the Case Category section and enter "Intermediate Processing"
2. Import this worksheet into the Non-disclosable folder
3. Go to Menu – Select File - For Manager Review – 74 & click (this will send the case to the manager)

**IP CHECKSHEET**
Alaska/Hawaii Case - 31515

Charter School (no management contract) - 31570

VEBA - 31506

Unable to close case on merit. Screen to IP group for the reason(s) checked below.

Do Not Refer Grade 13 Issues to IP

| Activities – | Organizational document – |
| Board – | Missing - |
| Effective date of exemption must be clarified – | Not filed - |
| Excessive legislative and/or political activities needs to be reviewed – | Does not meet org test – need amendment for |
| Financial – | |
| For-profit relationship needs to be explored (this includes successors, related, and/or involvement) - | Private benefit and/or inurement possible – |
| Foreign operations (check for possible terrorist countries, conduits, expenditure responsibility and/or related foreign for-profit entities) - | Private Operating Foundation (claiming POF, but is probably a public charity - |
| Foundation status needs to be reviewed | |

TEDS Processing:

1. Go to Menu – Click on blue button next to Case Information, click on the edit button in the Case Category section and enter “Intermediate Processing”
2. Import this worksheet into the Nondisclosable folder
3. Go to Menu – Select File - For Manager Review – 74 & click (this will send the case to the manager)
### Exhibit 7-3

**Draft EO Determinations**

**Screening Checksheet**

<table>
<thead>
<tr>
<th>Screener Name:</th>
<th>Date:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organization Name:</td>
<td>Case Grade:</td>
</tr>
</tbody>
</table>

**Select from the following reserved inventory categories only if case cannot be closed on merit:**

- Conservation Easements (31581)
- Donor Advised Fund (31491) - CL
- Down Payment Assistance (31561)
- Farmers’ Coop (31565)
- Foreign Organizations (31566)
- Gaming as Primary Activity (31567)
- Group Ruling (31568)
- Hedge Funds (31552) - CL
- LLC Applying Under 501(c)(3) (31563)
- Medical Marijuana (10100)
- Partnership or Joint Venture (31562)
- Private School (10200)

**Secondary Screening categories ("secondary screening required"):**

- 509(a)(3) Supporting Org (31998) – CL
- Carbon/Electric Credits (31895)
- Charter Schools (95994)
- Credit Counseling (31881) - CL
- Disaster Relief ** (31800)
- Health Care ** (31825)
- Potentially Abusive ** (31800)
- Potential Anti-Terrorism ** (31994)
- Potential Auto Revocation **

**Issues that generally merit full development:**

- Action Organizations Applying for 501(c)(3)
- Assigned Risk Insurance Activities
- Church (Single Family)
- For-Profit Relationship Including Successor to For Profit
- Housing with Sale of Housing
- Medical/Scientific Research (example – sponsored research for related for-profit)
- Operating in a Commercial Manner (example – ordinary sale of goods/services for a fee)
- Political Issues – Sensitive Issues
- Potential Denials/Other Adverse Action
- Previously Denied/Revoked Organizations
- Private School (Louisiana, Mississippi, and those with management contract)
- Professional Fundraiser (% fee arrangement)
- Related Party Transactions (example – lease with above FMV issues)
- Underwriting Municipal Insurance
- War-Related

**Other:**

- Reserved for EO Technical per IRM 7.20.1.4.1

**CL – Prepare and import applicable checklist**

<table>
<thead>
<tr>
<th>Screener:</th>
<th>Date:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organization’s Name:</td>
<td>Case Grade:</td>
</tr>
</tbody>
</table>
### Specialty Cases:
- Charter School w/management contract (31570)
- Conservation Easements (31581)
- Credit Counseling (31577) - CL
- Donor Advised Funds (31491) – CL
- Down Payment Assistance (31561)
- Farmers Coop’s (31565)
- Foreclosure Assistance (31607)
- Foreign Organizations (31566)
- Gaming as primary activity (31567)
- Group Rulings (31568)
- Hedge Funds (31552)
- LLC applying under 501(c)(3) - (31563)
- Partnership or Joint Venture (31562)
- 501(d), 501(e), or 501(f) (31576)
- 4942 – Set Asides
- 4945 – Advance Approvals
- VEBAs with less than 20 members (31506)

### Other Miscellaneous Cases:
- Action Organizations applying under 501(c)(3)
- Assigned Risk Insurance Activities
- Churches (single family)
- For-profit relationships (including successor to for profit)
- Housing with sales –
- Medical/Scientific Research (example: sponsored research for related for profit)
- Operating in a commercial manner (i.e., ordinary sale of goods or services for a fee)
- Political Activities – Sensitive Issues –
- Previously Denied/Revoked Organizations -
- Private Schools (Louisiana, Mississippi, and those with a management contract)
- Professional Fund Raisers - % fee arrangement
- Related party transactions (example: Lease with above fair market value issues)
- Underwriting Municipal Insurance
- Potential denials (example: organization set up to benefit 1 person, condo Assn)
- War-related – see IRM 7.20.5.3(o)
- Other reserved inventory
- Other issue discussed w/Manager. Specify issue:
- Potential Referral to EO Technical discussed w/Manager Issue:
- Comments

### Secondary Screening:
- Financial Literacy (31881) – CL
- Disaster Relief (31800)
- 509(a)(3) supporting orgs (31998) – CL
- Touch And Go (TAG) - -

### Direct Referrals to EO Technical*
IRM 7.20.1.3.4, IRM 7.20.5.4(3)r
- 501(c)(14) – credit unions
- 501(c)(15) small insurance companies
- 501(c)(25) – title holding companies
- 501(c)(26) – membership orgs
- 501(c)(27) – membership orgs

### Referrals to EO Technical Subject to Mandatory Review by QA*
IRM 7.20.1.3.4, IRM 7.20.5.4(3)r
- Commercial type insurance – 501(m) -includes applications under section 501(c)(3) or 501(c)(4) for pre-paid health care plans and HMO’s
- Hospital participating in whole hospital joint ventures – RR 98-15
- Faculty group practice organization
- Physician hospital organization (PHO)
- Individual practice association (IPA)
- Corporate practice of medicine (health provider formed under a State’s for-profit professional corporation laws)
- Integrated Delivery System
- Regional Health Information System (RHIO)
- Cooperative Hospital Service Orgs, IRC 501(e)
- Charitable risk pool – 501(n)
- Qualified state tuition plans - 529
- Applications from like orgs not specifically enumerated under IRC 501(c)(12)
- Church with activities wholly over internet
- Sole activity is provision of internet service (ISP)
- 501(c)(7) orgs with activities wholly over internet.
- Charitable fundraising activities wholly over internet with auction/percentage fee arrangements with for-profit entities
- Activities include extensive use of internet for lobbying or political activity
- Political host convention committee

**CL** - Prepare and import applicable checklist

* Screener prepares EO Tech Referral; see pp. 15-16 of Interim Guidelines for Cases Worked in TEDS, 12/16/08, for procedures.
Instructor Guide - Class Exercise 7-1

Lesson 7 - Introduction to the Form 1023 Application and Overview of Screening

1. Identify the following form numbers that might be used to apply for exemption:

_________________________ Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.

_________________________ Application for Recognition of Exemption Under Section 501(a) for organizations described in IRC sections 501(c) (2), (4), (5), (6), (7), (8), (9), (10), (12), (13), (15), (17), (19), and (25).

_________________________ is a “dummy” form number to establish applications for group exemption on the EDS system.

(ANSWERS: 1023, 1024, 1026)

2. A Form 1023 application for exemption under IRC section 501(c)(3) is divided into eleven parts. Identify the part of the form in which you would find the following information:

<table>
<thead>
<tr>
<th>Information</th>
<th>Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the organization a private foundation?</td>
<td>________</td>
</tr>
<tr>
<td>How will the organization raise its financial support?</td>
<td>________</td>
</tr>
<tr>
<td>Signature</td>
<td>________</td>
</tr>
<tr>
<td>Names and addresses of organization officers</td>
<td>________</td>
</tr>
<tr>
<td>Statement of Revenue and Expenses</td>
<td>________</td>
</tr>
<tr>
<td>Type of Organization</td>
<td>________</td>
</tr>
<tr>
<td>Employer Identification Number</td>
<td>________</td>
</tr>
</tbody>
</table>

Application Locations

<table>
<thead>
<tr>
<th>Part I – Identification of Applicant</th>
<th>Part IX – Financial Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part II – Organizational Structure</td>
<td>Part X – Public Charity Status</td>
</tr>
<tr>
<td>Part III – Required Provisions</td>
<td>Part XI – User Fee Information</td>
</tr>
<tr>
<td>Part IV – Narrative Description of Activities</td>
<td></td>
</tr>
<tr>
<td>Part V – Compensation and Other Financial Arrangements With Your Officers, etc.</td>
<td></td>
</tr>
<tr>
<td>Part VI – You Members and Other Individuals and Organizations That Receive Benefits</td>
<td></td>
</tr>
<tr>
<td>Part VII – Your History</td>
<td></td>
</tr>
<tr>
<td>Part VIII – Your Specific Activities</td>
<td></td>
</tr>
</tbody>
</table>


(Continued on next page)
Lesson 7 - Introduction to the Form 1023 Application and Overview of Screening

3. Form 1023 is supplemented by various schedules required from certain organizations seeking exemption under IRC section 501(c)(3). Identify the completed schedules required from the following:

<table>
<thead>
<tr>
<th>Organizations</th>
<th>Schedules</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Homes for the Aged or Handicapped and Low Income Housing</td>
<td>A</td>
</tr>
<tr>
<td>(b) Successors to Other Organizations</td>
<td>B</td>
</tr>
<tr>
<td>(c) 509(a)(3) Supporting Organizations</td>
<td>C</td>
</tr>
<tr>
<td>(d) Schools, Colleges, and Universities</td>
<td>D</td>
</tr>
<tr>
<td>(e) Churches</td>
<td>E</td>
</tr>
<tr>
<td>(f) Organizations Not Filing Form 1023 Within 27 Months of Formation</td>
<td>F</td>
</tr>
<tr>
<td>(g) Hospitals and Medical Research Organizations</td>
<td>G</td>
</tr>
<tr>
<td>(h) Organizations Providing Scholarships, Fellowships, etc. to Individuals…</td>
<td>H</td>
</tr>
</tbody>
</table>


4. Application Form 1023 is filed on the left hand side of a case file according to case file assembly procedures

(a) True (b) False

(Answer: False)
# Chapter 8

## Introduction to Case Development and Documentation

### Instructor Preparation

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>4 hours</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reference Materials</strong></td>
<td></td>
</tr>
<tr>
<td>- Instructor Guide, Chapter 8, Introduction to Case Development and Documentation</td>
<td></td>
</tr>
<tr>
<td>- Student Guide, Chapter 8, <em>Introduction to Case Development and Documentation</em></td>
<td></td>
</tr>
<tr>
<td>- Letter 1312, <em>Additional Information Requested</em></td>
<td></td>
</tr>
<tr>
<td>- Letter 2382, <em>Subsequent Request for Additional Information</em></td>
<td></td>
</tr>
<tr>
<td>- Form 5464-A, <em>EP/EO Case Chronology Record</em></td>
<td></td>
</tr>
<tr>
<td><strong>Training Aids</strong></td>
<td>TA 7-1, <em>Objectives</em></td>
</tr>
<tr>
<td><strong>Notes to Instructor</strong></td>
<td>Create a flip chart of the <em>Objectives</em> to display throughout the chapter, or create a transparency using TA 8-1.</td>
</tr>
</tbody>
</table>
Chapter 8
Objectives

After completing this chapter you will be able to:

• Identify items needing development

• Explain general guidelines to consider when working a case

• Identify the letters used to request additional information
• Describe proper questioning techniques

• Explain how to document actions on a case
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Chapter 8

Introduction to Case Development and Documentation

Overview

Introduction

Sometimes an application for exemption needs no development. The determinations specialist can determine that the applicant organization qualifies for exemption based upon the Form 1023/1024 and the supporting documentation provided by the organization.

Quite often an application does need development. This chapter provides guidance on how to develop a case.

Instructor Notes

Display and discuss the Objectives, or a review, on the flip chart.

Objectives

After completing this chapter you will be able to:

- Identify items needing development
- Explain general guidelines to consider when working a case
- Identify the letters used to request additional information
- Describe proper questioning techniques
- Explain how to document actions on a case
- Explain how case files are assembled

Continued on next page
This chapter contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
<td>1</td>
</tr>
<tr>
<td>Getting Started</td>
<td>3</td>
</tr>
<tr>
<td>General Guidelines</td>
<td>4</td>
</tr>
<tr>
<td>Reviewing the Application</td>
<td>5</td>
</tr>
<tr>
<td>Additional Information Requests</td>
<td>10</td>
</tr>
<tr>
<td>Questioning Techniques</td>
<td>14</td>
</tr>
<tr>
<td>Case Documentation</td>
<td>17</td>
</tr>
<tr>
<td>Case File Assembly</td>
<td>19</td>
</tr>
<tr>
<td>Summary</td>
<td>23</td>
</tr>
<tr>
<td>Exhibit 8-1: <em>Instructions for TAG Database</em></td>
<td>25</td>
</tr>
<tr>
<td>Exhibit 8-2: Letter 1312</td>
<td>29</td>
</tr>
<tr>
<td>Exhibit 8-3: Letter 2382</td>
<td>31</td>
</tr>
<tr>
<td>Exhibit 8-4: <em>14 - Day Follow-up Letter</em></td>
<td>33</td>
</tr>
<tr>
<td>Exhibit 8-5: Form 5464-A, <em>EP/EO Case Chronology Record</em></td>
<td>35</td>
</tr>
</tbody>
</table>
Getting Started

| Instructor Notes | Explain that cases are requested based on current inventory dates and levels, and group specialties. |
| Explain that requests are normally made on a sign-up sheet in the group. |

| Instructor Notes | Show students what a case looks like in EDS when it is assigned to them. |
| Refer back to the EO Determination Input Sheet – case grade, number, type, etc. |

When a Case is Assigned

A full development case is assigned to you in Status 52 in EDS.

Prior to starting work on the case, you will:

- Check the grade of the case on the EO Determination Input Sheet or case label
  
  Cases assigned to all trainees should be Grade 11. If the case is a Grade 12 or 13 case, it should be taken to your manager for possible reassignment.

- Start a Case Chronology Record (CCR)
  
  The CCR is updated as each action is taken on the case and is discussed later in this chapter. The first entry will always be “Case assigned.” Documenting the CCR is discussed later in this chapter.

- Assemble the case documents in case file assembly order (removing staples, other fasteners and any separator sheets) Current case file assembly order for determination cases is discussed in depth later in this chapter and can be found in IRM 7.20.2.6.
General Guidelines

The following general guidelines should be followed when working a case:

- Consider the Case Assignment Guide, TAG database, and BOLO listing. Discuss with your group manager prior to beginning work on any case that should have been a higher grade than designated on the EO Determination Input Sheet or case label or if it involves an identified TAG or BOLO issue.

- Generally cases should be worked on a “first in — first out” basis. Always work the oldest control dates in your inventory first unless a case is an approved expedite. Sometimes cases with older control dates may be assigned after cases with newer control dates.

- Do not mark or notate original documents. If the case reaches litigation, courts may deem unnecessary marking on the documents inappropriate.

- When an organization has submitted documents in a foreign language, request an English translation for the administrative record.

- Consider whether both the organizational and operational tests are met. Additional information may be needed in order to establish that the tests are met.

- Look at the application as a whole. Do not ask questions of the organization that are already provided somewhere in the application.

- Before asking the organization a question, consider “What difference does the answer to the question have on the determination?”

- Research applicable tax law. If you are unfamiliar with the type of issues in the case, research prior to requesting additional information.

- Consider any procedures that should be followed in the processing of the case including performing an OFAC check.
Reviewing the Application

Instructor Notes

Relate each item back to relevant Parts on Form 1023.

Types of Items

Review the application to determine whether any of the following are needed:

- Additional information on activities
- Additional financial information
- Amendments to organizing documents
- Corrections to forms
- User fee
- Signatures
- Other supporting documents

Continued on next page
Explain that a basic understanding of activities would include knowing how, where, when, what, why, and for whom.

Explain that the more complex the activities, more information may be needed in order to establish that the activities accomplish a 501(c)(3) purpose.

Before approving a Form 1023 or Form 1024 application, you must have a fundamental understanding of the organization’s activities.

- The organization must fully describe its past, current, and proposed activities. This description should include how the activities will be funded.

- Exempt status will be recognized in advance of operations if proposed operations are described in sufficient detail to permit a conclusion that the organization qualifies for exemption.

- A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes is not sufficient.

- Sometimes an organization will only provide an outline of its broad goals. You should request that it provide you with a detailed description of the activities it will conduct to achieve its goals.

For example, an organization has as its purpose or goal “to feed the poor.” Both its organizing document and its narrative of activities simply state “our mission is to feed the poor.” This is not a sufficient activity description to qualify the organization for exemption. You should ask, “How are you going to feed the poor? What specific activities will help you achieve your goals?”
Reviewing the Application, Continued

Understanding the Organization's Activities
The organization may then provide a detailed description for any of the following (or similar) activities:

- Soup kitchen
- Food pantry
- Meals on Wheels

Instructor Notes
Have class access sample paragraphs on the NERD Drive. Explain that many of the paragraphs have multiple parts, such as scholarships and facilities. Stress that when working an application, the student will need to analyze what has already been provided in order to determine what additional information is needed.

Asking the Right Questions
If you are uncertain about issues or items on Forms 1023/1024, it is your responsibility to develop those issues or items. The organization must provide adequate documentation to satisfy your concerns.

Though we require sufficient documentation, be careful not to overburden or overwhelm the organization with immaterial or redundant requests. For example, it is not necessary to request a completed page 9 of Form 1023 if sufficient budget information is provided in an attachment.

Instructor Notes
Explain that the names (individuals and organizations) and addresses listed on the application must be check against OFAC’s terrorist list.

OFAC Check
To help combat terrorism, all determinations specialists must search the Excel spreadsheet containing the Comprehensive List of Terrorists and Groups obtained from the Department of Treasury Office of Foreign Assets Control (OFAC) on all cases.

The specialists should complete the OFAC review and document the Case Chronology Record per current procedures which detail the appropriate actions to be taken. The CCR must document that an OFAC check/review was completed.

Continued on next page
Reviewing the Application, Continued

Instructor Notes

Explain to students how to access the list on the NERD Drive and how to document the CCR.

Current OFAC Procedures & Excel Spreadsheet

Information to be checked against the OFAC list includes names of individuals listed in the application (e.g., board members, individual and organizational grant recipients, donors, etc.), their addresses and the address of the organization, etc.

OFAC list matches (and partial matches) must be developed for possible terrorist connections or activities. A complete description of the information to be searched, the related procedures, and the updated Excel Spreadsheet containing the OFAC list are located in the NERD Drive under "Technical Issues - Anti-Terrorism."

Continued on next page
Reviewing the Application, Continued

Exhibit 8-1 Instructions for accessing TAG database.

BOLO Cases

The BOLO folder contains the most current Excel spreadsheet contains a comprehensive list of various types of case issues to “be on the lookout” for. The spreadsheet is updated as needed to add or remove names.

The BOLO Excel spreadsheet is separated into the following four (4) categories:

- Potentially Abusive
- Emerging Issues
- Coordinated Processing
- Watch List

A BOLO issue may develop from any type of case and at any time in the case processing. Many BOLO cases are identified in the screening process and sent to be worked in a specialized group.

If you identify a BOLO issue in a case assigned to you, discuss the case with your manager.
Additional Information Requests

Instructor Notes

Explain to class that if the information is germane to the organizational or operational test, then the information should be secured in writing.

Oral Requests

You need to distinguish whether needed information should be requested via telephone or in writing. The following types of information may be requested over the phone:

- Information that does not have an impact on the determination (either the organizational or operational test)
  For example, clarifying the fiscal year month
- Information that may be easy for the organization to provide
  For example, if the only item needed is the bylaws, then you could call the organization and ask for them to be faxed to you.

Oral requests for information should be fully explained on the Case Chronology Record, including the date by which the information is to be provided and the date on which to follow up with the organization.

Generally, allow one to three days for the organization to respond to oral requests for information. If the information has not been provided within the allotted time period, then a written request for information must be made.

Continued on next page
Additional Information Requests, Continued

| Instructor Notes | Explain that customer service is a big part of the job. We are educating the customer. This needs to be done in a professional and courteous manner. Discuss Exhibits 8-1, 8-2. (1312 and 2382 letters). Explain where to access copies of letters in the NERD Drive. |

| Written Requests | In situations where there are “if…then” scenarios, it is sometimes a good idea to call the organization for clarification prior to making a written request for information. Information should not be requested piecemeal. You should attempt to secure all needed information in one contact. Additional information letters should be written at an appropriate level for the contact. They should not contain IRS jargon and should be written in plain language. They should be professional in tone and appearance. The following letters are used: |

**Letter 1312** — Additional information request. This is the initial letter used when requesting information related to a Form 1023 or Form 1024 application (see Exhibit 8-1). The organization is given 21 days to respond to this request. |

**Letter 2382** — Subsequent requests for additional information. This letter is used for both Forms 1023 and 1024 if additional information is needed beyond what was provided in the response to our initial request for information (Letter 1312) (see Exhibit 8-2). The organization is given 14 days to respond to this request. |

The CCR should be updated to show that you have reviewed the case and prepared a request for additional information. It is important to note the follow-up date. The time spent should be recorded. |

*Continued on next page*
Additional Information Requests, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stress the importance of documenting all extensions on the CCR.</td>
</tr>
<tr>
<td>Discuss when to Suspend rather than grant an additional extension (past 35 days).</td>
</tr>
<tr>
<td>Discuss Exhibit 8-3 – 14 Day Follow up Letter.</td>
</tr>
</tbody>
</table>

### Extensions

If a response is not provided within the 21 days, call the organization to determine the status of the response. An extension of 14 days must be granted for the organization to provide the information. At this time, “Suspense” (administrative closure) procedures should be explained. (Suspense procedures will be discussed in Chapter 17, Case Closing.) If you are unable to reach the organization by telephone, then send a 14-Day Follow-up letter (see Exhibit 8-3).

If the organization has still not responded at the end of the 35-day period, you must call the organization, again, to inquire about the status of the response. An additional extension may be given if the organization is working with you to provide the information. Prior to granting an additional extension, consider:

- What information was requested?
- Can the organization provide part of the information now?
- How much time does the organization need to respond?

Extensions beyond the 35 days should not automatically be 14 days. A discussion should be held with the organization to find out what actions they need to take and how much time they need. You should discuss additional extensions beyond 14 days after the 35th day with your manager.

- Why has the organization not responded?
- Will the organization be able to provide the information before the new extension date?
- Does the organization need you to explain the request?

If additional time is not requested and/or granted, the case is ready to be closed as Suspense.

*Continued on next page*
**Additional Information Requests, Continued**

| Instructor Notes | Emphasize importance of signature and penalties of perjury declaration on a response. Explain that if the response is complete, the case is ready to close, if not, consider what information is still needed. In some situations, a call to the organization may resolve issues faster than writing for more information. |

**Response Received - Close Case or Request Additional Information?**

When requested additional information is received, review it to determine whether all information has been provided. Ensure the response is submitted over a penalties of perjury declaration and signed by an officer or director of the organization. Check any newly submitted names or addresses against the OFAC list and document your CCR.

If sufficient information is received and correctly signed, the case is ready to close.

If not, consider requesting additional information using Letter 2382. Consider the following:

- What information is still needed?
- Should the information be requested in writing or over the phone?
Questioning Techniques

Instructor Notes
Discuss questioning techniques – open ended questions, customizing canned paragraphs.

Asking the Right Questions

• Do not ask “yes” or “no” questions. Questions should produce an informative response from the taxpayer or contact.
  
  Example: Will you provide financial assistance to individuals?
  Better: Based on the information submitted, it appears that you may provide financial assistance to individuals. Describe in detail the requirements of those receiving benefits. List any restrictions on who may receive benefits.

  Example: Are directors or officers of your organization or their relatives eligible to receive assistance?
  Better: Describe in detail the procedures you will follow if an officer or director or their relative applies for assistance.

• Do not tell the contact what to do without telling them why or giving them an option to disagree.
  
  Example: Check box “g” on page 11 of Form 1023 and have an officer or director initial and date the change.
  Better: You have not requested a foundation classification. Based on the information provided in your application, it appears that you will be primarily supported by gifts, grants, and contributions from the general public. If this is correct, please check box “g” on page 11 of Form 1023 and have an officer initial and date the change. If you feel this classification does not best describe your organization, please explain.

• Do not ask closed ended questions.
  
  Example: Where do you conduct your activities?
  Better: Describe in detail the facility where your activities are conducted. How are the facilities financed and managed?
**Questioning Techniques, Continued**

**Asking the Right Questions (continued)**

- Do not overwhelm the taxpayer with law and IRS jargon.

  **Example:** Section 1.501 (c)(3) - 1(b)(1)(i) of the Regulations states:

  An organization is organized exclusively for one or more exempt purposes only if its articles of organization:

  (a) Limit the purposes of such organization to one or more exempt purposes; and

  (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

  Describe in detail how you assure compliance with the regulation.

  **Better:** Describe in detail each activity you conduct. For each activity indicate the percentage of total time devoted to the activity. Explain how each activity furthers charitable or educational purposes.

*Continued on next page*
Questioning Techniques, Continued

Asking the Right Questions (continued)

- Do not give legal advice.

Example: Based on the information submitted you will not qualify for exemption unless you do the following:
  
a. . . . .

b. . . . .

Better: Organizations described in section 501(c)(3) are specifically prohibited from political activities. Based on the information submitted it appears you may not qualify for exemption.
  
a. Describe in detail all political activities you have conducted. Give the exact date conducted and indicate the percentage of total time devoted to the activity.

b. Describe in detail any political activities you plan to conduct.

c. Describe in detail the procedures you will follow to assure compliance with section 501(c)(3) of the Code.
Case Documentation

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain each of the blocks on the CCR and what should be entered.</td>
</tr>
<tr>
<td>Stress that in documenting this form, enough information is needed in order to paint a picture of case history. Explain other individuals need to review the CCR at a future time, e.g. Group Manager, QA, an examination agent, a Specialist working an “A”, “F”, “P” or “T” case.</td>
</tr>
<tr>
<td>Discuss what should generally not be included on the CCR.</td>
</tr>
<tr>
<td>Explain that a CCR is required for every case type.</td>
</tr>
<tr>
<td>Discuss Exhibit 8-4 – Sample CCR.</td>
</tr>
</tbody>
</table>

Form 5464-A, EP/EO Case Chronology Record

A case chronology record (CCR) is required for every case and documents the determinations specialist’s actions, when actions take place, the amount of time spent on the actions. All actions on a case should be listed on the CCR including:

- Case assignment and closing
- Review of application and correspondence
- Research of EO law and research of EO/BMF, etc.
- Oral and written communications with taxpayers and authorized representatives
- Contact and discussion with IRS personnel including the manager, support unit, EO Technical, etc.

*(see Exhibit 8-4)*

Important to Document

Although the case chronology is not open for public inspection, it may be read by individuals other than IRS personnel (for example, if the case is being litigated). In order to make the document easy to read, it should be typed and should contain a chronological record of actions taken on the case.

Your documentation could be critical on a case if the organization is later identified as being potentially abusive and/or if fraud is suspected.

*Continued on next page*
Case Documentation, Continued

CCR Entries
Update the CCR each time an action is taken on the case. Include the following information for each item:

- Date each entry - mm/dd/yy
- Explain all delays in processing the case
- List the name of the person to whom you spoke (if the person is not an officer or other authorized representative, you should not discuss the facts of the particular case with them)
- List the Action Code
- Record the time spent on the case (the time recorded on the CCR should agree with the time recorded on the Excel spreadsheet attachment to your timesheet for each case)
- Briefly describe the action taken on the case (e.g., describe phone conversations or list actions – reviewed case, prepared 1312 letter, etc. Oral requests for information should include the information requested; however, the CCR should not be used to itemize case issues)
- Enter follow-up dates
- Explain extension requests (if an extension is denied, you should record how much time the organization requested and why the request was denied.)
- Avoid uncommon abbreviations
- Document OFAC check
- Do not make changes to the form itself

Instructor Notes
Provide brief explanation of case closing documentation (particularly issues and justification for exemption on 6038 Attachment) to be explained in Chapter 14 – Case Closing. Explain this type of information is generally not included on CCR.

Case Closing Documentation
Additional information must be documented at case closing. The required information and forms and worksheets will be discussed in Chapter 17, Case Closing.
Case File Assembly

EO specialists are responsible for ensuring that document in a case file are in the proper order and correctly placed in the case file according to current case file assembly guidelines. IRM 7.20.2.6, Case file assembly, states:

1. Determination specialists are responsible for properly assembling documents in the case file. Proper case file assembly:
   a. Helps managers, reviewers, specialists, conferees, and Appeals officers review the case.
   b. Reduces the risk of an improper disclosure by separating non-disclosable documents from documents that are available for public inspection.
   c. Assists in compiling the administrative record (as defined in Tax court Rule 210(b)(12)) in cases that are litigated under IRC 7428.

2. Minor deviations from the guide may be necessary in unusual situations.

3. If more than one case number applies to an organization, then separate case file folders should be prepared, one for each type of request. The Form 8670 will be attached to the appropriate file folder.

4. Proper case file assembly procedures for all types of cases are divided into the following basic categories:
   a. Forms to be placed on the outside of a case file folder.
   b. Information not open for public inspection (Non-Disclosable Documents).
   c. Information open for public inspection (under IRC 6103 and 6104) (Disclosable Documents).
   d. Items to be purged from the case file.

5. Case file assembly procedures will vary depending on whether a hard-copy case is established or the case is established in TEDS.

Continued on next page
Case File Assembly, Continued

**Hard-Copy Case File Assembly - General**

When a specialist is assigned a hard-copy case established in TEDS, all information that was created in TEDS or has been scanned into TEDS will be in the original hard-copy case file folder.

In addition to maintaining the original hard-copy case file folder, the specialist will create and maintain an orange folder for storing documents that have not been scanned into TEDS.

To ensure that Form 8670 and Form 3198-A (if applicable) are visible to the group secretary, manager, and Processing Section/Records Unit after case closing, the properly assembled orange folder will be:

- Placed inside the hard-copy case file or
- Rubber-banded behind the hard-copy case file.

---

**Guide for Hard Copy Case File Assembly – Front of File**

The following forms, if applicable, are to be attached to the front of the case file folder in the following order:

a. Form 3198A
a. Form 8670

*Continued on next page*
Case File Assembly, Continued

Left Side of File  Specialists will assemble the items that are not open for public inspection on the left side of the case file in the following order:

a. Floppy Disk including composed closing letter and closing forms required (place inside an envelope and paper clip the envelope to the left side of the case file folder)

b. Unexecuted memorandums to file pertaining to section 301.9100-1 relief

c. Forms requiring signature and documents to be forwarded to other functions (e.g., Form 5060, 5456, 5457, 5768, 5666)

d. Original EOMF/BMF documents to be input (e.g., Form 2363-A)

e. Form 5464-A, Case Chronology Record, in chronological order with oldest date on top

f. Copies of Form 2363 or 2363-A (includes the group exemption pilot voucher and list of subordinates)

g. Copy of Form 5666

h. Technical Screening Sheet (if merit closure case)

i. Form 6038

j. Attachments to Form 6038 (not required for merit closure cases)

k. Worksheets, checksheets (private school, computation of private foundation status, EOMF research prints, copy of signed Form 5060, etc.)

l. Copies of Form 8670 with prior case numbers assigned to the organization

m. Copies of Reviewer’s memoranda and other IRS memoranda or reports (Form 5456 and 5457, Form 12175, copy of user fee waiver/refund, EO Technical Post Review memoranda, EO Technical Case History, EIN merger memo, and memoranda to file)

n. Copies of user fee checks

o. Other non-disclosable information (e.g., patents, trade secrets, bank statements, etc.)

Right Side of File  Assemble the items that are open for public inspection on the right side of the case file. This material is disclosable under IRC 6104 when the application is approved. Note that there are special disclosure rules under IRC 6110 for denials. Refer to IRM 11.3, Disclosure of Official Information

Continued on next page
Case File Assembly, Continued

The right side of the case file will be assembled in the following order:

a. Determination letters (original plus file copy for each recipient and original plus file copy for each POA authorized to receive a copy)

b. Page 11 of Form 1023 signed by organization for advance rulings (original plus file copy and 1 additional copy for each POA)

c. Form 1023 Checklist

d. Form 2848, Power of Attorney, if filed and properly executed

e. Form 8821, Tax Information Authorization, if filed and properly executed

f. Application Form 1023, 1024 or 1028, upon which the determination was made and all related schedules.

g. All other attachments, including explanations, in page order

h. Form 8718 if filed

i. Organizing document

j. Amendments to organizing document in chronological order of filing

k. Bylaws and amendments in chronological order of date adopted

l. Documentation of nondiscriminatory policy required by Rev. Proc. 75-50 (if applicant operates a private school) or, if applicant operates a charter school, the documents related to the charter agreement. (Most Rev. Proc. 75-50 information will probably appear after Schedule B or the Bylaws. However, use facts and circumstances. For example, information within the text of a letter should remain in the correspondence section.)

m. Form 5768 (copy, original forwarded to Determination Processing Section)

n. Printed materials or publications which support the determination

o. Correspondence received from the organization and issued to the organization should be organized in chronological date order starting with the oldest date on top

p. Envelope showing the postmark date for IRC 508/505 purposes

Note: During case processing, the specialist may receive corrected or new pages of the application; place these directly behind the original page and purge photocopied pages.

Continued on next page
Case File Assembly, Continued

**Adverse Cases**  
In an adverse case, the case assembly of the right side of the case file is the same as above, except the information listed below will be placed first in the following order:

a. Proposed adverse letter (1 for each recipient)  
b. Publication 892  
c. Copy of proposed adverse letter stapled together for Quality Assurance  
d. Index  

**Note:** Accu-fasten the case file and tab each section.

**Purge Items**  
During the processing of a determination request, specialist may need to keep some materials that will be purged at case closing whereas other materials may be discarded. Specialist will clearly label and bundle the items that will be purged at case closing and place directly behind the contents on the right side of the file. The examples below are not all-inclusive lists. The specialist will apply facts and circumstances to decide which documents should be included. Nothing should be marked “Purge” in adverse cases.

Some examples of items that are purged at case closing are:

- Technical Screening Sheet  
- Form 8327  
- EO Determination Input Sheet  
- Publications, booklets, brochures, pamphlets, newsletters, etc., which do not support the approval of the determination  
- Leases that do not support the approval of the determination or reasonable 3rd party agreements  
- Request for Case Establishment on EDS Sheet  
- Unexecuted forms including invalid or rescinded Form 2848

Some examples of items that may be discarded by the specialist during processing are:

- Duplicate forms and letters  
- Blank forms and pages  
- Envelopes with no IRC 508 or IRC 505 issues
Sometimes an application for exemption needs no development and can be screened out. However, some applications need further development. This chapter provides guidance how to develop a case.

A case is assigned for full development in status 52 in EDS. Prior to starting work on the case, you will verify the grade of the case, add the case to your Excel spreadsheet, start a CCR, and put the case in case file assembly order.

Cases should be worked in a “first in – first out” basis. The application should be considered as a whole. Review the application to ensure you understand the organizations activities and to determine what information is missing from the application. General guidelines for case development include also consideration of the Case Assignment Guide and the BOLO list.

Information maybe requested via the telephone or in writing. Information requested orally should be information easy for the organization to provide or information that does not have an impact on the determination.

Asking the right question is very important in case development. In general, do not ask “yes” or “no” or close ended questions. You should not offer legal advice or overwhelm the organization with law or IRS jargon.

All actions on a case must be documented on the Case Chronology Record.
Dear Sir or Madam:

We need more information before we can complete our consideration of your application for exemption. Please provide the information requested on the enclosed Information Request by the response due date shown above. Your response must be signed by an authorized person or an officer whose name is listed on your application. Also, the information you submit should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this information, including accompanying documents, and, to the best of my knowledge and belief, the information contains all the relevant facts relating to the request for the information, and such facts are true, correct, and complete.

If we approve your application for exemption, we will be required by law to make the application and the information that you submit in response to this letter available for public inspection. Please ensure that your response doesn’t include unnecessary personal identifying information, such as bank account numbers or Social Security numbers, that could result in identity theft or other adverse consequences if publicly disclosed. If you have any questions about the public inspection of your application or other documents, please call the person whose name and telephone number are shown above.

To facilitate processing of your application, please attach a copy of this letter and the enclosed Application Identification Sheet to your response and all correspondence related to your application. This will enable us to quickly and accurately associate the additional documents with your case file. Also, please note the following important response submission information:
• Please don’t fax and mail your response. Faxing and mailing your response will result in unnecessary delays in processing your application. Each piece of correspondence submitted (whether fax or mail) must be processed, assigned, and reviewed by an EO Determinations specialist.

• Please don’t fax your response multiple times. Faxing your response multiple times will delay the processing of your application for the reasons noted above.

• Please don’t call to verify receipt of your response without allowing for adequate processing time. It takes a minimum of three workdays to process your faxed or mailed response from the day it is received.

If we don’t hear from you by the response due date shown above, we will assume you no longer want us to consider your application for exemption and will close your case. As a result, the Internal Revenue Service will treat you as a taxable entity. If we receive the information after the response due date, we may ask you to send us a new application.

*******************************DELETE IF NOT A 501(c)(3) APPLICATION*******************************

In addition, if you don’t respond to the information request by the due date, we will conclude that you have not taken all reasonable steps to complete your application for exemption. Under Internal Revenue Code section 7428(b)(2), you must show that you have taken all the reasonable steps to obtain your exemption letter under IRS procedures in a timely manner and exhausted your administrative remedies before you can pursue a declaratory judgment. Accordingly, if you fail to timely provide the information we need to enable us to act on your application, you may lose your rights to a declaratory judgment under Code section 7428.

*****************************DELETE IF NO POWER OF ATTORNEY*******************************

We have sent a copy of this letter to your representative as indicated in Form 2848, Power of Attorney and Declaration of Representative.

*********

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,
Enclosure: Information Request
Application Identification Sheet

Additional Information Requested:
*

PLEASE DIRECT ALL CORRESPONDENCE REGARDING YOUR CASE TO:

Selective: (EDS Cases)
US Mail: Street Address for Delivery
Service:
Internal Revenue Service
Exempt Organizations
P. O. Box 2508
Cincinnati, OH 45201
ATT: Specialist Name
Room XXXX
Group XXXX

(TEDS Cases)
US Mail: Street Address for Delivery

Service:

Internal Revenue Service
Exempt Organizations
P. O. Box 12192
Covington, KY 41012-0192

Internal Revenue Service
Exempt Organizations
201 Rivercenter Blvd
ATTN: Extracting Stop 312
Covington, KY 41011
Dear Sir or Madam:

Thank you for the information recently submitted regarding your application for exemption. Unfortunately, we need more information before we can complete our consideration of your application.

Please provide the information requested on the enclosed Information Request by the response due date shown above. Your response must be signed by an authorized person or an officer whose name is listed on the application. Also, the information you submit should be accompanied by the following declaration:

### Under penalties of perjury, I declare that I have examined this information, including accompanying documents, and, to the best of my knowledge and belief, the information contains all the relevant facts relating to the request for the information, and such facts are true, correct, and complete.

If we approve your application for exemption, we will be required by law to make the application and the information that you submit in response to this letter available for public inspection. Please ensure that your response doesn't include unnecessary personal identifying information, such as bank account numbers or Social Security numbers, that could result in identity theft or other adverse consequences if publicly disclosed. If you have any questions about the public inspection of your application or other documents, please call the person whose name and telephone number are shown above.
To facilitate processing of your application, please attach a copy of this letter and the enclosed Application Identification Sheet to your response and all correspondence related to your application. This will enable us to quickly and accurately associate the additional documents with your case file. Also, please note the following important response submission information:

- Please don’t fax and mail your response. Faxing and mailing your response will result in unnecessary delays in processing your application. Each piece of correspondence submitted (whether fax or mail) must be processed, assigned, and reviewed by an EO Determinations specialist.

- Please don’t fax your response multiple times. Faxing your response multiple times will delay the processing of your application for the reasons noted above.

- Please don’t call to verify receipt of your response without allowing for adequate processing time. It takes a minimum of three workdays to process your faxed or mailed response from the day it is received.

If we don’t hear from you by the response due date shown above, we will assume you no longer want us to consider your application for exemption and will close your case. As a result, the Internal Revenue Service will treat you as a taxable entity. If we receive the information after the response due date, we may ask you to send us a new application.

****************************************************************************************************
** DELETE IF NO POWER OF ATTORNEY **

We have sent a copy of this letter to your representative as indicated in Form 2848, Power of Attorney and Declaration of Representative.

****************************************************************************************************

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.
Sincerely yours,

Specialist Name
Exempt Organizations Specialist

Enclosures: Information Request
Application Identification Sheet
Additional Information Requested:

*,

PLEASE DIRECT ALL CORRESPONDENCE REGARDING YOUR CASE TO:

**Selective:**

(EDS Cases)

US Mail: Street Address for Delivery
Service:

Internal Revenue Service
Exempt Organizations
P. O. Box 2508
Cincinnati, OH 45201
ATT: Specialist Name
    Room XXXX
    Group XXXX

Internal Revenue Service
Exempt Organizations
P. O. Box 12192
Covington, KY 41012-0192
ATT: Specialist Name
    Room XXXX
    Group XXXX

(TEDS Cases)

US Mail: Street Address for Delivery
Service:

Internal Revenue Service
Exempt Organizations
P. O. Box 12192
Covington, KY 41012-0192
ATT: Extracting Stop 312
    Covington, KY 41011
Dear Applicant:

We sent you a letter requesting additional information we need in order to consider your application for exemption on *. We also attempted to contact your designated representative by telephone to try to obtain the requested information. We have not received a response to our information request.

Please provide the information requested in the enclosure by the due date shown in the heading of this letter. If we receive the information requested by the due date, we will continue to process your application for exemption under section 501(c)(*) of the Code. If we do not receive the information requested by the due date, we will be unable to consider your application for exemption further and will close your case.

If you have any questions or need assistance regarding our request for information, please contact me directly at the telephone number listed above.

Sincerely yours,

Specialist’s Name
Exempt Organizations Specialist

Enclosures:
Information Request (copy of 1312/2382 letter)
Letter 4423 (5-2011)
This page intentionally left blank.
# Exhibit 8-4

## EP/EO Case Chronology Record

<table>
<thead>
<tr>
<th>Date</th>
<th>Individual Contacted</th>
<th>Action Code</th>
<th>Time</th>
<th>Topics Discussed, Information/Amendments Requested or Other Action Taken</th>
<th>Follow-Up Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>2/21/08</td>
<td></td>
<td></td>
<td></td>
<td>Case Assigned</td>
<td></td>
</tr>
<tr>
<td>2/23/08</td>
<td>1, 2</td>
<td>2.0</td>
<td></td>
<td>Reviewed case file. Research IRM 7.25 and Reg. 1.501(c)(3)-1(d). OFAC Check/Review completed. No matches. Prepared Letter 1312 and sent to customer.</td>
<td>3/16/08</td>
</tr>
<tr>
<td>3/16/08</td>
<td>Contact Name</td>
<td>3</td>
<td></td>
<td>Called Contact Name to inquire on status of response. Extension requested to file amendment - granted. Asked organization to submit other items requested in the letter. She indicated she would send today. Explained FTE procedures to her.</td>
<td>3/30/08</td>
</tr>
<tr>
<td>3/21/08</td>
<td></td>
<td></td>
<td></td>
<td>Received partial response.</td>
<td></td>
</tr>
<tr>
<td>3/22/08</td>
<td>1, 3</td>
<td>1.0</td>
<td></td>
<td>Reviewed response. Information okay. OFAC check/review of new information. No matches. Still waiting on amendment.</td>
<td>3/30/08</td>
</tr>
<tr>
<td>3/30/08</td>
<td>Contact Name</td>
<td>3</td>
<td></td>
<td>Called by Contact Name. She indicated that she had called the state and that they were mailing the Amendment to her today. Requested an additional week to provide them. Granted additional week but asked her to fax the amendment to me upon receipt.</td>
<td>4/6/08</td>
</tr>
<tr>
<td>4/4/08</td>
<td>1, 2</td>
<td>1.0</td>
<td></td>
<td>Amendment to Articles received and reviewed. Prepared case for closing – Letter 1045, Form 8670, and Form 6038 and attachment. Case closed to manager.</td>
<td></td>
</tr>
</tbody>
</table>

### Action Codes
1. Review file, application, amendments/information
2. Correspondence
3. Telephone contacts
4. Examination or conference
   A. Employer/Administrator/Trustee Office
   B. Representative's Office
   C. District Office

### Remarks
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Lesson 8 - Introduction to Case Development and Documentation

1. It is a good idea to make notes on the submitted application form when reviewing an application.
   (a) True    (b) False

2. An organization must provide a full description of its activities before the specialist can make a determination.
   (a) True    (b) False

3. Use letter ________________ to make an initial request for additional information on an application for exemption.

4. Organizations are generally allowed _______ days to submit a response to a 2382 letter.

5. I. B. Agent prepared an additional information letter to a customer. In the letter, she asked, “Do you pay rent?” Is this a good question to ask the organization? Why or why not?

6. A specialist’s actions on a case are documented on Form ________, ________________________________________________________.

Answers: 1. False  2. True  3. 1312  4. 14 days  5. No. A question that can be answered with a “yes” or “no” response do not tend to produce an informative response from the taxpayer or contact.  6. 5464-A
Chapter 9

IRC Section 501(c)(3) Operational Test

Instructor Preparation

Estimated Time
5 hours

Reference Materials
- Course book
- Lesson handouts
- Class exercises

Training Aids
- TA 9-1, Objectives

Continued on next page
Chapter 9
Objectives

After completing this chapter you will be able to:

• Explain the requirements to satisfy the operational test

• Discuss the concept of “operating exclusively.”

• List the exempt purposes specified in the statute
• Explain how an organization may carry on a trade or business and still be exempt

• Define inurement

• Identify which types of exempt organizations have inurement as a potential issue

• Identify potential inurement on Form 1023 applications

• Resolve inurement issues
• Define private benefit

• Distinguish between inurement and private benefit

• Identify private benefit on Form 1023 applications
Chapter 9
IRC Section 501(c)(3) Operational Test

Overview

Introduction

Treas. Reg. 1.501(c)(3)-1(a)(1) states, “In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt.”

While the organizational test relates to an organization’s organizing document, the operational test relates to the organization’s operations.

An organization satisfies the operational test if it meets the following three requirements:

• Primary activities - The organization engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC section 501(c)(3).

• Distribution of earnings - The organization’s net earnings do not inure in whole or in part to the benefit of private shareholders or individuals.

• Action organizations - The organization is not operated exclusively for one or more exempt purposes if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise.

This chapter discusses the first and second requirements. The third requirement is discussed in Lesson 15.
Overview, Continued

Objectives

After completing this chapter you will be able to:

- Explain the requirements to satisfy the operational test
- Discuss the concept of “operating exclusively”
- List the exempt purposes specified in the statute
- Explain how an organization may carry on a trade or business and still be exempt
- Define inurement
- Identify which types of exempt organizations have inurement as a potential issue
- Identify potential inurement on Form 1023 applications
- Resolve inurement issues
- Define private benefit
- Distinguish between inurement and private benefit
- Identify private benefit on Form 1023 applications

Continued on next page
Overview, Continued

In This Chapter

This chapter contains the following topics:

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<td>Primary Purposes</td>
<td>9-4</td>
</tr>
<tr>
<td>Purpose vs. Activity</td>
<td>9-7</td>
</tr>
<tr>
<td>Reviewing Form 1023 – Purposes and Activities</td>
<td>9-10</td>
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<tr>
<td>Inurement</td>
<td>9-12</td>
</tr>
<tr>
<td>Reviewing Form 1023 – Inurement</td>
<td>9-18</td>
</tr>
<tr>
<td>Reviewing Supporting Documents - Inurement</td>
<td>9-20</td>
</tr>
<tr>
<td>Resolving Inurement Issues</td>
<td>9-22</td>
</tr>
<tr>
<td>Private Benefit</td>
<td>9-24</td>
</tr>
<tr>
<td>Some Private Benefit is Allowable</td>
<td>9-27</td>
</tr>
<tr>
<td>Reviewing Form 1023 and Supporting Documents – Private Benefit</td>
<td>9-31</td>
</tr>
<tr>
<td>Summary</td>
<td>9-33</td>
</tr>
</tbody>
</table>
Primary Purposes

Instructor Notes
Stress to class that the purposes for which an organization must be operated are the same as those for which they must be organized.

Exempt Purposes
An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC section 501(c)(3).

The purposes specified in IRC section 501(c)(3) are:

- Religious
- Charitable
- Scientific
- Testing for public safety
- Literary
- Educational
- Fostering national or international sports competition
- Prevention of cruelty to children or animals

Instructor Notes
Explain the concepts of exclusively, primarily, and insubstantial.

Continued on next page
Primary Purposes, Continued

<table>
<thead>
<tr>
<th>Meaning of “Operated Exclusively”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treas. Reg. 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes if it engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC section 501(c)(3). It further provides that an organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hand out Rosenberg’s rules. Stress that the percentages are not law, but a useful guideline. The various percentages were taken from different court cases, and different court cases assign different percentages for the same terms. On whiteboard, write down various percentage values assigned to exclusively, primarily, and insubstantial.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explain that this term is common in referring to the exemption of an applicant. Each case must rest on its own merits – “facts and circumstances” of the case.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Facts and Circumstances</th>
</tr>
</thead>
<tbody>
<tr>
<td>The terms “exclusively,” “primarily” and “insubstantial” are not legally defined. Often, exemption is determined on the basis of proposed activities and so activities conducted for exempt and non-exempt purposes cannot be easily measured. Questions involving the application of these terms can be more readily resolved on the basis of the facts and circumstances of a particular case. It is important to ensure that all facts and circumstances are fully developed.</td>
</tr>
</tbody>
</table>

Continued on next page
### Example – Not Operated for Exempt Purpose

If an organization is not operated exclusively for one or more exempt purposes, it will not qualify for exemption.

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352 (1978), the court ruled that the organization did not qualify for exemption under IRC section 501(c)(3) because it was not operated for any purpose(s) specified in IRC section 501(c)(3).

B.S.W. Group, Inc. was formed to provide consulting services for a fee to non-profit, although not necessarily exempt, clients. The services provided would be an alternative to full-time staffing of clients where budget considerations and lack of expertise prevented such staffing. The court stated that helping clients to seek a substitute for full-time staffing is not inherently charitable, scientific, or educational. The court concluded by stating the following:

> “...We are unable to find that petitioner’s primary purpose is educational, scientific or charitable ...the conduct of an ordinary commercial consulting enterprise in competition with other commercial firms.”

### Substantial Non-Exempt Purpose

An organization is not operated exclusively for exempt purposes if it has a single **non-exempt purpose** that is **substantial** in nature. This is true regardless of the number or importance of the organization’s exempt purposes.

In *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279 (1945), the U.S. Supreme Court ruled that an organization which engaged in some educational activities, but pursued non-profit goals outside the scope of the statute, was not exempt under IRC section 501(c)(3). *Better Business Bureau* – they had some educational activities, but also had substantial nonexempt purposes (investigate and expose unethical business practices - commercial hue to its purposes)
Purpose vs. Activity

Instructor Notes

Have students read Treas. Reg. Section 1.501(c)(3)-1(e)(1).
(Comment: Please emphasize the following point during training - An organization is exempt on the basis of its purpose and not its activities. However, an organization’s purpose may be inferred from its activities. An organization’s true purpose is determined in light of the totality of facts in a particular case.)

Carrying on a Trade or Business

Under the operational test, **it is the purpose** and **not the nature of the activities which is critical.**

An organization may carry on a trade or business as a substantial part of its activities if the operation of such activity is in furtherance of the organization’s exempt purposes. In determining the existence of such primary purpose, all the facts and circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities. Treas. Reg. 1.501(c)(3)-1(e)(1)

Instructor Notes

Stress that the business directly helped to accomplish the organization’s exempt purpose.

Business in Furtherance of Exempt Purpose


The organization was formed to provide vocational training to unskilled persons unable to find employment. The organization’s job training program centered on the manufacture and sale of a line of toy products.

*Continued on next page*
Purpose vs. Activity, Continued

Business in Furtherance of Exempt Purpose (continued)

The program provided these unskilled persons with new skills through on-the-job training while they were earning a living. Trainees were not hired as permanent employees and the organization tried to place them in permanent positions in the community as soon as they were trained. More unskilled persons were then recruited as new trainees to continue the training process.

The IRS noted that there was no evidence that the scale of the operation was such that it was being conducted on a larger scale than was reasonably necessary to accomplish the organization’s charitable purpose. The IRS ruled that the manufacturing activities were an integral part of the training process and, therefore, an integral part of the organization’s charitable program.

Instructor Notes

Explain that the training program was the exempt purpose of the organization. The operation of the retail grocery store did not serve to solely achieve that purpose.

Stress the concept that organizations are exempt on the basis of their purpose rather than on their activities. Organizations which are not engaged in inherently charitable activities may nevertheless qualify for exemption under IRC 501(c)(3) if they are operated exclusively for exempt purposes. For example, although a PTO, which devotes 100 percent of its activities to fundraising by selling T-shirts on behalf of a public school, may nonetheless qualify for exemption under IRC 501(c)(3) on the premise that it is operated to serve a public purpose. The PTO, in this case, is not directly engaged in educational activities, but its purpose is to support a public institution which does provide public education. On the other hand, some organizations claim to be formed for educational or charitable purposes but upon closer examination of its service contracts with related for-profit entities, it becomes apparent that the organizations' true purpose is to serve the private interests of its insiders. Hence, the critical factor in determining whether the organization meets the operational test is predicated on the organization's true purpose.

Continued on next page
The situation in Rev. Rul. 73-127, 1973-2 C.B. 221, provides a contrast to the one above.

In this revenue ruling, the organization was formed to operate a retail grocery store to sell food to residents of a poverty area at prices substantially lower than those charged by competing grocery stores and to provide job training for unemployed residents.

The store’s gross earnings were used principally to pay salaries and to expand the operations of the store. Only about four percent of the store’s earnings were allocated for use in a continuous training program for the hard-core unemployed. Some of the trainees became permanent employees at the grocery store.

Based on the facts and circumstances, the IRS concluded that the operation of the organization was conducted on a scale larger than was reasonably necessary for the performance of the organization’s training program. Since the operation of the grocery store did not serve solely as a vehicle for carrying out the training program, exemption under IRC section 501(c)(3) was denied.
Instructor Notes

Stress that most activity descriptions are proposed activities, so the organizations can revise their estimates of what percentage of time they plan to spend on each activity.

Consider Exempt and Non-Exempt Purposes

In order to determine the exempt purposes of the organization, you must first go to the organizing document to see why the organization was formed.

Form 1023, Part IV, *Narrative Description of Your Activities*, asks applicants to describe their past, present, and planned activities in a narrative and Part VIII, *Your Specific Activities*, asks applicants to complete a series of "Yes" or "No" questions regarding their specific activities. This information should be closely reviewed in order to determine:

- Whether the activities are conducted to further one or more exempt purposes and
- Whether the activities further a non-exempt purpose

If a non-exempt purpose exists, the specialist must determine if the non-exempt purpose is substantial. If the non-exempt purpose is substantial, the organization will not meet the operational test for exemption under IRC section 501(c)(3). If the non-exempt activity is incidental and less than substantial, it will not result in denial of exemption.

*Continued on next page*
Explain that organizations may qualify under another subsection even if they do not qualify under section 501(c)(3) – give example.

Consider Qualification under another Subsection

If the non-exempt activity is substantial and constitutes a necessary part of its activities in order to achieve its purpose, consideration might be given to exemption under another subsection.

Example:

In Rev. Rul. 67-293, 1967-2 C.B. 185, an animal pound organized and operated to prevent cruelty to animals and substantially engaged in promoting legislation for the protection and benefit of animals was held exempt under IRC section 501(c)(4) rather than IRC section 501(c)(3).

The substantial legislative activities of the organization precluded exemption under IRC section 501(c)(3), but its purpose and activities were nevertheless within the scope of IRC section 501(c)(4).

Note: Exemption requirements under other subsections will be discussed in Unit 1b.
# Inurement

## Instructor Notes

Tell the class to add the word “inurement” to their vocabulary. Explain the concept that primary, substantial, etc. does not apply to inurement. Any inurement will result in denial under section 501(c)(3).

## Inurement

An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private individuals. Many application denials are based on inurement.

This section addresses inurement in IRC section 501(c)(3) organizations only.

## Public v. Private Purposes

Treas. Reg. 1.501(c)(3)-1(d)(1)(ii) provides that to meet the operational test, an organization must be operated to further “public” rather than “private” interests. *B.S.W.* – organization did not differ from a for-profit consulting business.

## Instructor Notes

Have class access applicable sections in the Code and Regs.

IRM 7.25.3.16.1 – applicable IRM reference (Inurement – Benefits to Insiders)

## Inurement Defined

IRC section 501(c)(3) provides, in part, for the exemption from Federal income tax for organizations organized and operated exclusively for charitable, religious or educational purposes, **no part of the net earnings of which inures** to the benefit of any private shareholder or individual.

- Treas. Reg. 1.501(c)(3)-1(c)(2) states an organization is not operated exclusively for the statutory purposes if its net earnings inure to the benefit of individuals.

- Treas. Reg. 1.501(c)(3)-1(d)(1)(ii) states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. **It must not be operated for the benefit of designated individuals or the persons who created it.**
Inurement, Continued

**Inurement Defined (continued)**

Treas. Reg. 1.501(a)-1(c) states the “words private shareholder or individual” in IRC section 501 refer to persons having a personal and private interest in the activities of the organization.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Have class access applicable sections in the Code and Regs.  IRM 7.25.3.16.1 – applicable IRM reference (Inurement – Benefits to Insiders)</th>
</tr>
</thead>
</table>

**Who Are Insiders?**

Write the list of “insiders” on the whiteboard. For inurement to exist, an “insider” must receive financial gain because of their position within the exempt organization. Insiders include:

- Trustees
- Board members
- Officers
- Members
- Founders
- Significant donors
- Employees

Individuals with a close professional working relationship with the exempt organization.

*Continued on next page*
Inurement, Continued

Examples of Inurement

Inurement may exist in many forms. Some examples are:

- Unreasonable compensation
- Payment of excessive rent
- Detained or retained interests
- Receipt of less than fair market values in sales or exchange property
- Unsecured or inadequately secured loans
- Prohibitive benefit from funds
- Exempt organizations providing capital improvements to property owned by its insiders
- Copyrights and royalties benefiting insiders
- Interest free and/or unsecured loans to insiders
- Dividends

Instructor Notes

Examples of inurement. - Go through each type – go around the class and have someone read each bullet point. Stress that specialists will encounter these issues constantly as they work determination cases.

- Example 1 – Unsecured or inadequately secured loans
- Example 2 – Prohibitive benefit from funds
- Example 3 – Created for personal gain
- Example 4 – Payment of excessive rent – Texas Trade School – organization operated the school on property leased to it by the organization’s officers. The lease payments exceeded fair market value.
- Example 5 – Unreasonable compensation

Continued on next page
Inurement, Continued

Example 1: Unsecured or Inadequately Secured Loans

In *John Marshall Law School and John Marshall University v. United States*, 81-2 USTC 9514 (CT. CL. 1981), the court found inurement to exist when a family controlled school provided interest free unsecured loans to family member officers of the school. In addition to the loans, family members received payments for non-business related expenses, such as travel, entertainment, and health spa membership. The court sustained the Service’s decision to revoke the school’s exemption under IRC section 501(c)(3) for the years 1967-1973.

The school has since expanded its board of trustees so that a majority of trustees are not related. Family member compensation is now controlled by an independent board. Also, the school’s bylaws have been amended to provide that the trustees can no longer vote on their own compensation. Effective January 28, 1993, the school is exempt under IRC section 501(c)(3).

Example 2: Prohibitive Benefit from Funds

In *Wendy L. Parker Rehabilitation Foundation v. C.I.R.*, T.C. Memo 1986-348, the court found inurement to exist and denied exemption to the applicant organization.

The organization was created to:

“aid the victims of coma, resulting from motor vehicular accidents, stroke, drowning, and other related causes; to provide such coma victims, who are in various stages of rehabilitation and recovery, with funds and therapeutic equipment and devices used in conjunction with accepted coma recovery programs; to run fundraising affairs and social functions in aid of coma victims; to exchange and disseminate information concerning the care and treatment of coma victims in all stages of recovery.”

Continued on next page
Inurement, Continued

Example 2: Prohibitive Benefit from Funds (continued)

Wendy Parker was a coma victim. Her family maintained complete control over the organization. All of the officers were related to Wendy Parker. Thirty percent of the organization’s income was expended to benefit Wendy Parker.

The court stated:

“The distributions of funds for the benefit of Wendy Parker assist the Parker family in providing for her care. These funds will be used to pay for the medical and rehabilitative care of Wendy Parker. This relieves the Parker family of the economic burden of providing such care. Consequently, there is a prohibitive benefit from the petitioner’s funds that inures to the benefit of private individuals.”

Example 3: Created for Personal Gain

Revenue Ruling 81-94, 1981-1 C.B. 330, provides another example of inurement. A “church” was formed by a professional nurse for personal gain.

The corporation was formed under the name of ABC Church. The founder was a professional nurse who held a “certificate of ordination” purchased from an organization selling such certificates and church charters. The nurse was the corporation’s minister, director, and principal officer. She maintained full-time employment with a third-party employer having no connection with the corporation.

Pursuant to a vow of poverty, she transferred all of her assets, including her home and car, to the organization. Her nursing salary was directly deposited in the “church” account. The corporation paid all of the nurse’s living expenses, including use of her home and car.

The Service held:

“The nonprofit corporation described above operates to serve the private interests of a designated individual and thus is not operated exclusively for religious or charitable purposes. Therefore, it does not qualify for exemption from federal income tax under section 501(c)(3) of the Code.”

Continued on next page
Inurement, Continued

Example 4: Payment of Excessive Rent

Often organizations will rent facilities, equipment, or other property from officers or directors of the organization. Rent can be paid at no more than fair market value for the property received. Excessive rent paid will result in the inurement of earnings to private individuals.

(See Texas Trade School v. Commissioner, 30 T.C. 642, aff'd, 272 F.2d 168 (5th Cir. 1959))

Example 5: Unreasonable Compensation

In determining whether compensation is unreasonable, consideration must be given to:

- Qualifications
- Duties
- Hours

Treas. Reg. 1.162-7(b)(3) states:

"In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is, in general, just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned."
Reviewing form 1023 – Inurement

Instructor Notes
Review questions on the Form 1023 with the class which may help us identify potential inurement.

Form 1023
Determinations specialist must always look for potential inurement issues when reviewing 1023 applications. A good place to start is the Form 1023 itself.

Part I
• What is the name of the organization? Does it suggest that the organization was set up to benefit a designated individual?

Part IV
• Determine how the organization will achieve its exempt purpose – what activities will be conducted and how will they be conducted?

• Determine who benefits from the activities.

Part V
• Determine who controls the organization – who are the insiders?

• Will compensation be paid to insiders? Does the organization’s board have broad representation from the community it serves? Or is the board dominated by one or two individuals or families?

• Who is compensated? Based on the information provided, was the compensation negotiated at arm’s length? Is it reasonable?

• Carefully analyze any written agreements or contracts to determine that terms were negotiated at arm’s length.

Part VI
• Determine who receives benefits from the organization.

Continued on next page
Reviewing form 1023 – Inurement, Continued

Form 1023 (continued)

Part VII

• If the organization answers yes to Line 1 in this Part, they will complete Schedule G of the application. The schedule should be scrutinized carefully to determine whether the assets and liabilities transferred were at fair market value.

Part VIII

• Carefully consider each “yes” answer in this part and how the activity may result in inurement.

Part IX

• Carefully analyze expenses to determine where the money is going.

Schedules

• Analyze schedules to determine who will be providing services, facilities, and who will benefit.
Reviewing Supporting Documents - Inurement

**Instructor Notes**

Explain that everything the organization submits along with the Form 1023 could provide insight into potential inurement.

**Organizing Document/Bylaws**

In addition to reviewing the 1023 application, you must review the following supporting documents:

- Organizing document – This document should show who controls the organization, the purpose of the organization and if dividends will be distributed.

- Bylaws - This document will normally describe the organizational structure of the organization. For example, how many officers the organization will have and what their duties are.

*Continued on next page*
**Reviewing Supporting Documents - Inurement**, Continued

**Other Places to Look**

If a review of the 1023 application indicates that the organization has any of the following items, they may be requested and reviewed:

- Contracts
- Rental or Leasing agreements
- Copyrights
- Patents
- Loans
- Deeds

**Other Places to Look**

When reviewing the above items the following issues may be addressed:

- Is it reasonable?
- Is it well documented?
- Was it negotiated at “arm’s length”?
- Who negotiated it?
- Who will have ultimate control?
- Who will benefit?
- Who has final approval?
- Is there a conflict of interest?
Resolving Inurement Issues

Instructor Notes

Tell the class that as they gain more experience, they will start to realize which applications can be “fixed” and which cannot. Are they merely unsophisticated taxpayers that need guidance? If they have already begun operations, will they agree to exemption as of the date they agree to discontinue certain activities? Or, is there no way to “fix” the activities (immediate denial appropriate)?

This is a good opportunity to remind the class of the ROO and how it works.

Approval or Denial?

It is the determinations specialists’ responsibility to take the facts presented by the applicant, apply tax law to those facts and make a determination – recommend approval or denial of the application. Case files should be developed to the extent necessary to ensure the requirements of the law are met. Some cases require little to no development, while others require substantial development to ensure all facts are secured and clear.

In cases where inurement exists, meaning that the organization is structured so that inurement is inevitable, and/or has already occurred, the application will be denied exemption under IRC section 501(c)(3).

Continued on next page
Resolving Inurement Issues, Continued

**Modifications**

However, some potential inurement issues may be resolved. Consideration should be given all facts and circumstances of the case. The organization may be asked to:

- Expand the board to place control in the hands unrelated persons selected from the community it will serve
- Place compensation lease or contract decisions in the hands of unrelated persons to ensure transactions are at arm’s length
- Adopt a conflict of interest policy

In any case, the service **cannot require** any of these things as a condition of exemption. If the organization refuses, it may be appropriate to approve the case based on the facts and circumstance and then write a follow-up request for the Review of Operations Unit (ROO).

No modifications should be requested unless it is clear that the organization’s activities are designed to accomplish an IRC section 501(c)(3) exempt purpose.
**Private Benefit**

Public v. Private Interest/Burden of Proof

Treas. Reg. 1.501(c)(3)-1(d)(1) states, in part, that an organization is not organized or operated exclusively for one or more exempt purposes:

…unless it serves a public rather than a private interest. Thus, to meet the requirement of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such interests.

When reviewing a Form 1023, the determinations specialist must look at all proposed activities closely to determine if the organization will serve public rather than private interests.

The burden of proof is on the applicant organization. It must provide adequate documentation to demonstrate that the public will benefit from its activities.

Inurement v. Private Benefit

The terms inurement and private benefit are not interchangeable. Private benefit is broader than inurement. All inurement is private benefit but not all private benefit is inurement. The two primary differences are:

- Any amount of inurement can endanger an organization’s exemption. However, the organization’s exemption will not be endangered if private benefit is insubstantial and incidental.

- Inurement is limited to insiders only. Private benefit is not limited to insiders.

Continued on next page
Private Benefit, Continued

Example 1: School Bus

Rev. Rul. 69-175, 1969-1 C.B. 149, describes an organization that was formed by parents of students attending a private school. The sole purpose of the organization was to provide bus transportation to and from school for the members’ children. Parents paid an initial family fee and an additional annual charge for each child. The organization’s income equaled the operation’s expenses. The organization applied for exemption under IRC section 501(c)(3). The revenue ruling states:

“When a group of individuals associate to provide a cooperative service for themselves, they are serving a private interest. By providing bus transportation for school children, under the circumstances described, the organization enables the participating parents to fulfill their individual responsibility of transporting their children to school. Thus, the organization serves private rather than a public interest. Accordingly, it is not exempt from Federal income tax under section 501(c)(3) of the Code.”

Example 2: Nurses Registry

Rev. Rul. 61-170, 1961-2 C.B. 112, discusses an organization composed of professional private duty nurses and practical nurses, which supports and operates a nurses’ registry primarily to afford greater employment opportunities for its members. The revenue ruling states:

“On the basis of the information presented, the instant organization is primarily engaged in the performance of personal services by operating an employment service principally for the benefits of its members.”

This revenue ruling found that the organization did not qualify for exemption under IRC section 501(c)(3) or IRC section 501(c)(6).
Private Benefit, Continued

Example 3:
Copyrights/Trade Names/Patents

Though Unit 1 does not include the development of scientific research organizations, the following revenue ruling provides an excellent example of public versus private benefit.

Rev. Rul. 65-1, 1965-1 C.B. 226, discusses an organization that promotes and fosters the development and design of farm machinery.

The organization is empowered to acquire and to hold, own, use, and to sell, design, and grant licenses or territorial rights and to otherwise dispose of, assign, and lease any copyrights, trade names, or letters patent of the United States.

The revenue ruling found:

...the development of a new machine, the patents of which may be licensed on a restrictive basis to selected manufacturers, is directed toward benefiting those particular manufacturers and any benefit to the public must be considered indirect.

The organization did not qualify for exemption under IRC section 501(c)(3).

Example 4:
Secondary Private Benefit

In *American Campaign Academy v. Commissioner of Internal Revenue*, 92 T.C. 1053, the court held that the operation of a school to train individuals to fill responsible positions in campaigns of Republican candidates for political office provided a personal benefit to unrelated third parties who were not a charitable class.

The court sustained the Service’s denial of exemption of the Academy under IRC section 501(c)(3) because more than an insubstantial part of their activities were to provide private benefit to individuals.
Some Private Benefit is Allowable

When reviewing Form 1023 applications, the determinations specialist must determine who benefits from the organization’s activities, the general public or private individuals. The mere existence of private benefit may not endanger the exemption. The determinations specialist must look at the facts and circumstances and analyze:

- The amount of the private benefit
- How the benefit is given or received
- Whether the benefit is limited to a particular group or geographical area

Frequently, IRC section 501(c)(3) organizations, such as museums, symphonies, nature centers, zoos, aquariums, etc., offer gift shop discounts, free admissions, discount admissions, special events, etc., to members only. These activities are permissible if they are directly related to the organization’s exempt purposes and if they are small when compared to the organization’s total activities.

Sometimes, organizations provide personal services that are totally unrelated to their exempt purposes, for example, group insurance benefits. These organizations must be looked at closely. Depending on how substantial the service is, this type of private benefit may endanger the organization’s exemption.

The organizations described in the following revenue rulings illustrate how facts and circumstances make a difference.
Some Private Benefit is Allowable, Continued

Example 1:  
City Beautification

Rev. Rul. 68-14, 1968-1 C.B. 243, found that an organization that was organized and operated to preserve and develop the beauty of a city qualified for exemption under IRC section 501(c)(3). The revenue ruling states:

By planting trees in public areas and assisting municipal authorities in their programs to plant trees and keep the city clean, the organization is lessening the burdens of government. The organization’s informational program directed to the public, architects, and builders is educational. The overall effect of these activities is to combat community deterioration. Accordingly, the organization is exempt from Federal income tax under section 501(c)(3) of the Code.

Example 2:  
Block Association

Rev. Ruling 75-286, 1975-2 C.B. 210, found that an organization with membership limited to the residents and business operators within a city block and formed to preserve and beautify the public areas in the block, thereby benefiting the community as a whole as well as enhancing the members’ property values, did not qualify for exemption under IRC section 501(c)(3), but did qualify under IRC section 501(c)(4).

Its activities consisted of paying the city to plant trees on public property within the block, organizing residents to pick up litter in the public streets and sidewalks within the block, and encouraging residents to take an active part in beautifying the block by placing shrubbery in public areas within the block. Membership was restricted to residents of the block and those owning property or operating businesses there. The revenue ruling states:

By enhancing the value of the roadway sections abutted by property of its members, the organization is enhancing the value of its members’ property rights. The restricted nature of its membership and the limited area in which improvements are made, indicate that the organization is organized and operated to serve the private interests of members within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Accordingly, although the organization is primarily engaged in promoting the general welfare of the community, it is not organized and operated exclusively for charitable purposes. Therefore, it does not qualify for exemption under section 501(c)(3) of the Code.

Continued on next page
Some Private Benefit is Allowable, Continued

Facts and Circumstances

Both organizations in Examples 1 and 2, above, were organized to beautify an area. Both organizations planted trees and organized community clean-up projects. However, the first organization’s activities were citywide while the second organization limited its activities to a city block. These revenue rulings illustrate the importance of the facts and circumstances of a particular case.

Examples of When Some Private Benefit is OK

The following examples further illustrate that some private benefit is permissible.

Park/Brand Symbol

A corporation contributed funds and land adjacent to its plant reception area to an organization exempt under IRC section 501(c)(3). The exempt organization used the funds and land to establish a public park.

Rev. Rul. 66-358, 1966-2 C.B. 218, held acceptance of this gift by the organization will not affect its exempt status even though the donor retained the right to continue using the picture of a certain scenic view in the park as its brand symbol.

Preservation of Lake

An organization was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. It was financed by contributions from lake front property owners, from members of the community adjacent to the lake, and from municipalities bordering the lake.

Rev. Rul. 70-186, 1970-1 C.B. 128, held the organization to be exempt under IRC section 501(c)(3) stating:

The benefits to be derived from the organization’s activities flow principally to the general public through the maintenance and improvement of public recreational facilities. Any private benefits derived by lake front property owners do not lessen the public benefits flowing from the organization’s operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

Continued on next page
Some Private Benefit is Allowable, Continued

Private Benefit Exceeds Public Interest

The following two examples illustrate cases in which private interest exceeded public interest.

**Example:**

In *Benedict Ginsberg and Adele W. Ginsberg v. Commissioner*, 46 TC 47 (1966), the organization was formed to provide a haven or refuge in time of danger from storms or the elements for small craft in distress, to dredge the waterways or channels for the purposes stated above and for the further purposes of improving the health, recreational and other considerations of such waterways or channels. In addition, the organization would maintain such waterways or channels.

The court found the general public had no direct access to the water, and the owners of waterfront property were assessed dredging cost based on frontage. This demonstrated that the dredging was undertaken by owners primarily to benefit themselves and not the general public and the organization did not qualify as exempt under IRC section 501(c)(3).

**Example 2:**

An organization was formed to provide low-income housing to families. However, preference was given to employees of a farm proprietorship operated by the individual who created and controlled the applicant organization.

Rev. Rul. 72-147, 1972-1 C.B. 147, held:

Providing housing for low income families may be a charitable activity. However, since the organization gives preference for housing to employees of the farm proprietorship operated by the individual who created and controls the organization, and all the units are in fact occupied by such employees, the organization is serving the private interest of the individual rather than a public interest.

The organization did not qualify for exemption under IRC section 501(c)(3).
# Reviewing Form 1023 and Supporting Documents – Private Benefit

## Form 1023
To determine whether private benefit exists, the determinations specialist should review the activities closely. Recap the various sources of information in the 1023 application (and supporting documents) where a specialist may uncover private benefit. Distinguish from looking for inurement. Stress that anyone can receive private benefit. It matters if it is insubstantial or incidental.

## Organizing Document/Bylaws
In addition to reviewing the Form 1023 application, you must review the organizing document and bylaws.

- Organizing document - This document should show the organization’s exempt purpose and who will benefit from its activities.

- Bylaws - This document should describe the organizational structure. If the organization has members, does it have different classes of members? If yes, do their benefits differ?

## Other Places to Look
If your review of the Form 1023 application indicates that the organization has any of the following items, they may be requested and reviewed:

- Newsletters
- Brochures or flyers
- Newspaper clippings or articles about the organization
- Advertisements
- Literature

The above items are excellent sources that the determinations specialist can use to gain a true understanding of the organization’s activities.

*Continued on next page*
Reviewing Form 1023 and Supporting Documents – Private Benefit, Continued

<table>
<thead>
<tr>
<th>What to Look For</th>
<th>The following issues should be addressed:</th>
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<tr>
<td></td>
<td>• Who will benefit?</td>
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<td>• Is the benefit for the general public or is it for private interests?</td>
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<td>• How much benefit is given? Is it substantial or insubstantial?</td>
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<td>• Is the benefit limited to a particular group or geographic area?</td>
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</table>
Summary

An organization must meet the operational test in addition to the organizational test to receive exemption under section 501(c)(3). In order to meet the operational test, the primary activity of the organization must accomplish one or more exempt purposes and the organization may not allow earnings to inure to private shareholders or individuals. In addition, the organization may not operate as an action organization.

An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC section 501(c)(3).

Under the operational test, it is the purpose and not the nature of the activities which is critical.

If a non-exempt purpose exists, the specialist must determine if the non-exempt purpose is substantial. If the non-exempt purpose is substantial, the organization will not meet the operational test for exemption under IRC section 501(c)(3). If the non-exempt activity is incidental and less than substantial, it will not result in denial of exemption. If applicable, you should consider other subsections.

Inurement is a financial gain by an “insider” of an exempt organization. Insiders include Trustees, board members, officers, founders, employees, etc. Often Form 1023 is the best place to start when identifying inurement. The form details the financial information of the organization and provides information on who controls the organization. The organizational document and bylaws may also provide information on who controls the organization. Depending on the facts and circumstances of the case, some potential inurement issues maybe need to be resolved.

The determinations specialist should ensure the proposed activities will serve public rather than private interests. Private benefit is broader than inurement. All inurement is private benefit but not all private benefit is inurement. Private benefit is not limited to insiders. Some private benefit maybe allowable if it is incidental; however, no amount of inurement is allowable.
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Chapter 10

IRC Section 501(c)(3) – Charitable Organizations Purposes and Types

Instructor Preparation

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<td>Reference Materials</td>
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<tr>
<td>Instructor Guide, Chapter 10, IRC Section 501(c)(3) – Charitable Organizations Purposes and Types</td>
<td></td>
</tr>
<tr>
<td>Student Guide, Chapter 10, IRC Section 501(c)(3) – Charitable Organizations Purposes and Types</td>
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<tr>
<td>Training Aids</td>
<td>TA 10-1, Objectives</td>
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<tr>
<td>Notes to Instructor</td>
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<tr>
<td>Create a flip chart of the Objectives to display throughout the chapter, or create a transparency using TA 10-1.</td>
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Chapter 10
Objectives

After completing this chapter you will be able to:

• Describe the major types of charitable organizations

• Identify organizations which provide relief to the poor, distressed or underprivileged

• Identify organizations which provide assistance to the elderly or handicapped
• Explain the various ways transitional housing can serve charitable classes of individuals
• Identify organizations that promote health
• Identify organizations that prevent cruelty to children or animals
• Identify amateur sports organizations
Chapter 10
IRC Section 501(c)(3) – Charitable Organizations
    Purposes and Types

Overview

Introduction

IRC section 501(c)(3) provides for the exemption of organizations organized and operated exclusively for “charitable” purposes. Charity is an evolving concept that changes with societal needs.

This chapter covers some of the basic types of organizations that are described as “charitable” within the meaning of IRC section 501(c)(3). Explain that relief of the poor, distressed or underprivileged encompasses a broad range of charitable organizations.

Objectives

After completing this chapter you will be able to:

- Describe the major types of charitable organizations
- Identify organizations which provide relief to the poor, distressed, or underprivileged
- Identify organizations which provide assistance to the elderly or handicapped
- Explain the various ways transitional housing can serve charitable classes of individuals
- Identify organizations that promote health
- Identify organizations that prevent cruelty to children or animals
- Identify amateur sports organizations

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Overview, Continued

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</table>
“Charitable” Defined

Instructor Notes
Ask an overhead question – what kinds of activities would you consider charitable? (Do not look at text!)
Have class find charitable organizations in IRM 7.25.3.5

Concept of Charity

The concept of charity was developed in common law before the Internal Revenue Code existed. (Scott on Trusts, section 368 (3rd ed. 1967), provides a thorough analysis of the generally accepted legal interpretation.)

Determining which activities are in furtherance of charitable purposes is not limited to interpretations of IRC section 501(c)(3). Charity is not a static concept. The concept of what is charitable varies with the time, place, and needs of a particular community. The concept of what is charitable is still evolving.

However, common to all definitions of charity is the concept of broad public benefit. This public benefit is brought about either by financially supporting the activities of particular charities or by conferring direct benefits on the community at large.

Instructor Notes
Have students access Reg. 1.501(c)(3)-1(d)(2).
Have students read off the bulleted “generally accepted legal sense” charitable purposes listed below.

Continued on next page
“Charitable” Defined

Generally Accepted Legal Sense

Treas. Reg. 1.501(c)(3)-1(d)(2) provides that the term “charitable” is used in IRC section 501(c)(3) in its generally accepted legal sense. To emphasize that this does not mean simply relief of poverty, the regulation then lists the following examples of purposes which are charitable in the legal sense:

- Relief of the poor and distressed or of the underprivileged
- Advancement of religion
- Advancement of education or science
- Erection or maintenance of public buildings, monuments, or works
- Lessening the burdens of government

Promotion of social welfare by organizations designed to accomplish any of the above purposes

- To lessen neighborhood tensions
- To eliminate prejudice and discrimination
- To defend human and civil rights secured by law
- To combat community deterioration and juvenile delinquency

Rev. Rul. 69-545, 1969-2 C.B. 117, included the promotion of health as an independent charitable purpose.

Charitable Class

The group of individuals that may properly receive assistance from a charitable organization is called a charitable class. A charitable class must be large or indefinite enough that providing aid to members of the class benefits the community as a whole.

Continued on next page
### “Charitable” Defined

<table>
<thead>
<tr>
<th>Large or Indefinite</th>
<th>Assistance to pre-selected, specifically named individuals will preclude exemption. Refer to Rev. Rul. 67-367, 1967-2 C.B. 188.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>However, the mere limiting of assistance to a relatively small membership of a restricted class will not necessarily preclude exemption. Refer to Rev. Rul. 56-403, 1956-2 C.B. 307.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Charitable Groups</th>
<th>In general, a charitable class may include, but is not limited to, any of the following groups of individuals:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Poor: Persons who are at or below federal poverty guidelines</td>
</tr>
<tr>
<td></td>
<td>• Elderly: Generally defined as persons at least 62 years of age</td>
</tr>
<tr>
<td></td>
<td>• Handicapped: Persons afflicted with a physical or mental handicap</td>
</tr>
<tr>
<td></td>
<td>• Distressed: For example, individuals who have suffered from a disaster</td>
</tr>
<tr>
<td></td>
<td>• Youth: Children under the age of 18</td>
</tr>
</tbody>
</table>
**Relief of the Poor, Distressed, or Underprivileged**

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that relief of the poor, distressed or underprivileged encompasses a broad range of charitable organizations</th>
</tr>
</thead>
</table>

**Introduction**

Relief of the poor, distressed, or underprivileged is a charitable purpose that can take many forms including meeting the basic human needs of food, shelter, and clothing.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Stress that we use these kinds of revenue rulings as our basis for exemption when recommending a case for approval</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Advise class that low-income housing is a Grade 12 issue.</td>
</tr>
<tr>
<td></td>
<td>Rev. Rul. 69-441: Stress that abusive credit counseling cases are placed under close scrutiny and worked by designated groups.</td>
</tr>
<tr>
<td></td>
<td>Explain that in some cases where activities are inherently charitable, there may be no revenue ruling on point. In these cases, the specialist will cite Reg. 1.501(c)(3)-1(d)(2) as precedent to support their conclusion on the attachment to Form 6038.</td>
</tr>
</tbody>
</table>

*Continued on next page*
Providing assistance in the following situations is charitable:

**Assisting Low-income Individuals or Families to Obtain Adequate Housing**

- Rev. Rul. 70-585 provides exemption to an organization formed to construct new housing and to renovate existing housing for sale to low-income families on long-term, low payment plans. (see also Rev. Rul. 67-138 and Rev. Rul. 76-408)

- Rev. Proc. 96-32 provides safe harbor guidelines under which organizations that provide low-income housing will be considered charitable as described in 501(c)(3) because they relieve the poor and distressed.

**Public Housing Tenant Group**

- Rev. Rul. 75-283, 1975-2 C.B. 201, provides exemption to a statewide association of local public housing tenant groups that advises its member groups on topics such as the rights and responsibilities of tenants and the laws and regulations concerning public housing.

**Providing Financial Counseling**

- Rev. Rul. 69-441, 1969-2 C.B. 115, provides exemption to an organization that assists low-income individuals and families with financial counseling and assists them in establishing budget plans where necessary.

**Providing Day Care**

- Rev. Rul. 68-166, 1968-1 C.B. 255, provides exemption to an organization that showed that enrollment was limited to children of low-income families.

- Rev. Rul. 70-533, 1970-2 C.B. 112, provides exemption under IRC section 501(c) (3) to an organization that was operating a day care center for children of needy working parents.
Relief of the Poor, Distressed, or Underprivileged, Continued

<table>
<thead>
<tr>
<th>Assistance to Low-Income Families (continued)</th>
<th>Providing for Basic Human Needs (Shelter, Food, Clothing, Etc.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Restatement of Trusts (2d ed. 1959)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Self-Help Programs</th>
<th>Programs are often used to eradicate poverty by helping others to help themselves. In these cases, it is critical to determine how the organization will operate. Distinction must be made from commercial ventures.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marketing Cooking and Needlework</td>
<td>• Rev. Rul. 68-167, 1968-1 C.B. 255, provides exemption to an organization created to market the cooking and needlework of needy women.</td>
</tr>
<tr>
<td>Assistance in Developing Countries</td>
<td>• Rev. Rul. 68-117, 1968-1 C.B. 251, provides exemption to an organization formed and operated to assist needy families in developing countries.</td>
</tr>
<tr>
<td>Student Exchange</td>
<td>• Rev. Rul. 68-165, 1968-1 C.B. 253, provides exemption to an organization that joins with a foreign country to promote student and cultural exchange and to provide technical and material assistance for self-help projects.</td>
</tr>
</tbody>
</table>
Assistance to the Elderly

Charitable Class

The elderly are generally recognized as a charitable class. Organizations that satisfy the needs of the elderly can be charitable as relieving the poor, distressed, or underprivileged. These special needs have been identified as:

- Housing
- Health care
- Financial security

Instructor Notes

Explain the concept of substantial as it relates to the number of individuals being served that are over 62.

Who Are “The Elderly”? 

When working applications from organizations serving the elderly, the primary guidance used to define the eligible class of individuals comes from the following:

- Rev. Rul. 79-18, 1979-1 C.B. 194
- GCM 37101 (1977)

Rev. Ruls. 72-124 and 79-18 both pertain to organizations that limit services to individuals who are at least 65 years of age. GCM 37101 (1977) allows exempt status for an organization serving individuals who are at least 62 years of age. Although GCMs are not to be cited as precedent, this one employs the same age restrictions defined in the National Housing Act and related legislation. Therefore, the Service generally uses the age of 62 as a cutoff to include individuals in a charitable class by reason of being elderly.

Continued on next page
Assistance to the Elderly, Continued

| Instructor Notes | Advise students that Elderly Housing is a Grade 12 issue. Direct students to Schedule F. Go through questions relating to elderly housing. |
| Elderly Housing and Health Care | Organizations that provide housing and health care for the elderly will generally qualify for exemption if the organization provides residential facilities that are specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of the elderly. Although a home for the elderly certainly does not have to provide all of these, some special aspects should be provided in order to distinguish the home from others. Rev. Rul. 79-18 provides exemption to an organization that provided housing to the elderly at the lowest feasible cost and maintained in residence those who became unable to pay. Elderly housing will be discussed in more advanced training. |
| Instructor Notes | Reiterate that these activities constitute relief of the poor, distressed, or underprivileged. |

Continued on next page
Common services for the elderly include:

### Rural Rest Home

- Rev. Rul. 75-385, 1975-2 C.B. 205, provides exemption to an organization that operates a rural rest home to provide, at a nominal charge, two-week vacations for elderly people from nearby metropolitan areas.

### Senior Citizen Center

- Rev. Rul. 75-198, 1975-1 C.B. 157, provides exemption to an organization that establishes a service center providing information, referral and counseling services relating to health, housing, finances, education and employment, as well as a facility for specialized recreation for senior citizens of a particular community, who need not become members to obtain services or participate in activities.

### Employment Agency


### Low Cost Bus Transportation

- Rev. Rul. 77-246, 1977-2 C.B. 190, provides exemption to an organization providing, upon request, low cost bus transportation to senior citizens and handicapped persons in a community where public transportation is unavailable or inadequate.

### Meal Delivery

- Rev. Rul. 76-244, 1976-1 C.B. 155, provides exemption to an organization that delivered meals to the elderly.

*Continued on next page*
The following are examples of organizations serving the elderly which did not meet the requirements for IRC section 501(c)(3):

**Pensions**

- Rev. Rul. 68-422, 1968-2 C.B. 207, describes an organization created to pay pensions to all retired employees of a certain company. The pension benefits are paid to all retired employees age 65 or over, regardless of their economic resources. It did not qualify for exemption because it did not pay pensions on the basis of need, and there was no attempt to show that the retired employees as a class lacked the necessities or comforts of life.

**Retail Stores**

- *Senior Citizens Stores v. United States*, 602 F. 2d 711 (5th Cir. 1979), describes an organization whose stated purpose was to provide training, jobs, and recreation for senior citizens by operating retail stores. Although it incidentally served the needs of seniors, the evidence indicated that the retail sales operation was an end in itself. Proceeds from the business were used almost exclusively for its perpetuation. The organization did not qualify for exemption since its primary activity was the operation of the retail store, which was not devoted exclusively to charitable purposes.

**Pharmaceutical Service**

- *Federation Pharmacy Services, Inc. v. Commissioner*, 625 F. 2d 804 (8th Cir. 1980), dealt with a nonprofit pharmaceutical service providing pharmacy services to the general public. It provided special discount rates for handicapped and seniors in its area, although it was not committed to providing any drugs below cost or free to indigents. Although its services did improve health in the area, it did not qualify for exemption because it was primarily a commercial venture operated in competition with other area pharmacies.
Assisting the Sick or Handicapped

Helping the Sick

The following revenue rulings provide precedent for organizations assisting the sick to qualify under IRC section 501(c)(3). These organizations relieve the burdens of the poor, distressed, or underprivileged. Again, assistance to pre-selected, specifically named individuals will preclude exemption. Refer to Lesson 9, which discussed an organization formed to aid Wendy Parker, a specifically named coma victim. The fact that the organization was formed to assist a pre-selected sick individual precluded exemption.

Services to Friends and Relatives Comforting Patients

- Rev. Rul. 81-28, 1981-1 C.B. 328, provides exemption under IRC section 501(c)(3) to an organization that provides housing, transportation, and counseling to hospital patients’ relatives and friends who travel to the locality to assist and comfort the patients.

Hospice

- Rev. Rul. 79-17, 1979-1 C.B. 193, provides exemption to an organization providing hospice services that operates on both inpatient and outpatient care to alleviate the physical and mental distress of the terminally ill.

Blood Bank


Ministering to the Non-medical Needs of Patients

- Rev. Rul 68-73, 1968-1 C.B. 251, provides exemption under IRC section 501(c)(3) to an organization ministering to the non-medical needs of patients in a proprietary hospital. Services include reading to patients, writing letters for them, and providing similar personal services.

Continued on next page
Assisting the Sick or Handicapped

**Instructor Notes**

Be alert for small, family-run group homes formed to benefit private individuals.

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**Handicapped**

Generally, the various services provided to the elderly that are provided to handicapped individuals would also be considered charitable. The same rationale applied to organizations offering housing, transportation, and employment to the elderly is also applied to the handicapped, as they are also included in a charitable class of individuals. This would include services to both the physically and mentally handicapped.

Housing for the handicapped will be discussed in more advanced training.
Assisting the Distressed

Instructor Notes

Explain that the organizations listed in this section may also relieve the burdens of government.

Introduction

Some organizations offer services to those who are in distress. This would include the provision of funds or services to those who have suffered through a disaster, such as a natural disaster or an act of terrorism. As previously mentioned in this lesson, aid must be directed to a large or indefinite charitable class, as contrasted with limiting assistance to a few specific individuals, such as those affected by a particular fire or plane crash. For more information, consult Pub. 3833, Disaster Relief.

Instructor Notes

Disaster relief – regardless of the income level of the individual, providing for immediate basic needs is a charitable purpose (food, water, shelter, etc.)

Many fire stations are governmental and have no need to apply for exemption

Disaster Relief

Community Welfare

- Rev. Rul. 71-99, 1971-1 C.B. 151, provides exemption to an organization formed to provide food and drink to firemen, policemen and other emergency personnel at the scene of fires, riots and other disasters.

Continued on next page
### Disaster Relief (continued)

**Volunteer Fire Company**
- Rev. Rul 74-361, 1974-2 C.B. 159, provides exemption to an organization that was organized and operated to provide fire protection and ambulance and rescue services to a community.

**Disaster Relief**
- Rev. Rul. 69-174, 1969-1 C.B. 149, provides exemption to an organization that was formed to offer emergency rescue services to stranded, injured or lost persons, as well as provide emergency services to persons suffering because of fire, flood, accident or other disaster.

### Other Organizations Relieving Distress

The following types of organizations were found to relieve distress and thus qualify for exemption under IRC section 501(c)(3):

**Posting Bail**
- Rev. Rul. 76-21, 1976-1 C.B. 147, provides exemption to an organization that, as a part of its integrated program of providing legal and rehabilitative, employment and other services to persons accused of crimes, posts its own money or property as bail for indigent defendants.

**Prisoner Rehabilitation**
- Rev. Rul 70-583, 1970-2 C.B. 114, provides exemption to an organization operating a community correctional facility to provide rehabilitation for prisoners selected by the courts.
Transitional and Temporary Housing

Instructor Notes

Unlike low-income and elderly housing, transitional/temporary housing is only a Grade 11 issue

Housing as a Charitable Activity

A housing organization must provide housing in a charitable manner in order to qualify for exemption under IRC section 501(c)(3). This can be accomplished by serving charitable purposes such as relief of the distress of the elderly or physically handicapped, combating community deterioration, or lessening the burdens of government.

Many organizations further such charitable purposes by operating transitional or temporary housing programs. The most commonly seen applications of this nature offer housing to individuals such as ex-convicts, recovering drug addicts, battered women, pregnant teenagers and the homeless.

Shelter is Basic Necessity of Life

Rev. Rul. 69-174, supra, stresses that a nonprofit organization formed to provide free rescue and emergency services to distressed persons may be exempt under IRC section 501(c)(3).

This rationale for exemption also applies to organizations providing transitional or temporary housing for a charitable class of individuals. Much like food, clothing and medical assistance, shelter is considered a basic necessity of life.

Continued on next page
Temporarily, individuals may not be self-sufficient as a result of a sudden and severe personal or family crisis, for example, victims of physical abuse. They are often in a similar position to those affected by a natural disaster that are temporarily in need of food or shelter when stranded, injured or lost.

Unlike low-income and elderly housing organizations which have established criteria for exemption, there are no specific requirements to be met by organizations operating transitional or temporary housing. Much like the “distressed test” used to evaluate disaster relief organizations, these organizations must simply make an objective assessment that a recipient of services is in need.

The individuals requiring transitional or temporary housing may be considered distressed irrespective of financial condition.

Typically, these organizations limit the lengths of stay of their clients to a reasonable amount of time for them to once again become self-sufficient. What constitutes a reasonable amount of time would depend on the facts and circumstances of the application. One recovering drug addict may sober up after six months, while another may require a couple of years. The halfway house would likely rely upon the advice of a health professional to decide whether or not the individual is ready to seek permanent housing elsewhere.

The following revenue rulings describe the typical classes of individuals who benefit from the provision of transitional or temporary housing services:

- Rev. Rul. 75-472
- Rev. Rul. 67-150
- Rev. Rul. 72-16
- Rev. Rul. 69-473
Rev. Rul. 75-472

Rev. Rul. 75-472, 1975-2 C.B. 208, holds that an organization formed to operate a halfway house and organized to provide room, board, therapy, and counseling for persons discharged from alcoholic treatment centers qualified for exemption under IRC section 501(c)(3).

Clients are admitted because they are not currently capable of achieving a satisfactory social standing or gaining employment on their own. They need a temporary home and a transitional atmosphere as a means of regaining their emotional and physical health, and reacquiring self-respect and confidence in their own capabilities.

The organization's program is designed to bridge the span between the end of the residents' intensive treatment for alcoholism and the return to a normal and productive life through the integration of residential and work experience.

The activities serve to promote the health of the individual and improve their capabilities and thus further charitable and educational purposes.

Rev. Rul. 67-150

Rev. Rul. 67-150, 1967-1 C.B. 133, describes an organization furthering the rehabilitation of ex-convicts and parolees by providing them with counsel and financial assistance, helping them secure employment, and conducting other programs to make them better citizens.

The organization is serving charitable and educational purposes by assisting ex-convicts and parolees and by acquainting the public with the problems encountered by such persons.

The ruling does not specifically mention transitional housing; however, an applicant formed to furnish transitional housing for ex-convicts and parolees would qualify for exemption under IRC section 501(c)(3) for the same reasons as the organization described in this ruling.
Transitional and Temporary Housing, Continued

Rev. Rul. 72-16
Rev. Rul. 72-16, 1972-1 C.B. 143, describes an organization providing a residence facility and therapeutic group living program for individuals recently released from a mental institution.

Such individuals frequently find the transition to independent existence extremely difficult. A high percentage of them become discouraged and return to the refuge offered by the mental institution. Those unable to cope with the responsibilities inherent in supporting themselves become wholly dependent on their families or local welfare agencies.

The organization was formed to offer an alternative to such individuals and to aid in reducing the rate of readmissions to the mental institution.

The organization, through training and counseling, is educating former mental patients to improve their vocational, social and emotional capabilities and, thereby, become self-supporting and contributing members of society. Accordingly, the organization's activities are charitable, and it qualifies for exemption under IRC section 501(c)(3).

Rev. Rul. 69-473
Rev. Rul. 69-473, 1969-2 C.B. 37, describes a program conducted by a charitable organization to assist indigent unmarried pregnant women.

Although the ruling mainly addresses deductibility issues under IRC section 170(c)(2), the concepts involved are directly applicable to organizations providing temporary housing for a similar charitable class of individuals. Just like the organization in the ruling, charitable housing organizations typically furnish their beneficiaries with a proper diet, clothing, and a small weekly allowance.

Temporary housing activities for unmarried pregnant women would generally serve charitable interests under IRC section 501(c)(3).
Promotion of Health

Instructor Notes

Advise class that hospitals are Grade 13 cases.
Stress that it is difficult to distinguish between nonprofit and for-profit hospitals. The Service is currently revisiting the issue to ensure that nonprofit hospitals are providing adequate levels of charity care.
Refer students to Form 1023, Schedule C.

Hospitals

The promotion of health as a charitable activity is most commonly associated with the operation of a hospital. Organizations promoting health in this manner may be charitable provided they are not operated in a proprietary manner and the class of beneficiaries is sufficiently large and indeterminate to benefit the public as a whole. Rev. Rul. 69-545, 1969-2 C.B. 117, provides exemption for a hospital with the following characteristics:

- Governed by a board of trustees consisting of prominent citizens in the community.
- Medical staff privileges are available to all qualified physicians in the community.
- The hospital operates a full time emergency room and no one requiring emergency care is denied treatment. (a hospital that does not operate an emergency room may qualify as a hospital under specified circumstances (Rev. Rul. 83-157, 1983-2 C.B. 94.))
- The hospital otherwise limits treatment to those able to pay, either themselves or through third-party payers, such as insurance or public programs like Medicare.
- All surplus funds are used to improve the quality of patient care, expand its facilities, and advance its medical training, education, and research programs.
- Qualification as a hospital under IRC section 501(c)(3) will be discussed in more advanced training.

Continued on next page
Promotion of Health, Continued

Promotion of Health

Organizations promoting health under IRC section 501(c)(3) are not necessarily hospitals; they may be small clinics, usually in rural or inner-city settings. They may be organized to treat patients suffering from a wide range of illnesses or only those suffering from a particular condition. Such organizations may not have the need for an emergency room or for a wide variety of staff practicing different specialties as are generally found in true hospitals.

Examples of this type of organization include a rural medical clinic serving the poor and a women’s health clinic only serving those needing maternity care.

Serving a Public Interest

The promotion of health is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole. Organizations promoting health must serve public rather than private interests.

This is true even though the class of beneficiaries eligible to receive a direct benefit, such as the indigent, may not include all members of the community, provided that the class is not so small that its relief is not of benefit to the community.

Community Benefit Standard

The community benefit standard is the test used for determining if a health care provider is operated to promote health in a way that accomplishes a charitable purpose. The community benefit standard was first applied to hospitals; however, the Service and the courts have applied this standard to non-hospital health care providers as well, who also must demonstrate that they meet the community benefit test.

To meet this test, a health care provider must make its services available to all in the community, plus provide additional community or public benefits. The benefit must either further the function of government-funded institutions or provide a service that would otherwise not likely be provided within the community. Furthermore, the additional public benefit conferred must be sufficient to give rise to a strong inference that the public benefit is the primary purpose for which the organization operates. In conducting this inquiry, we consider all of the relevant facts and circumstances.

Continued on next page
Be alert for RHIOs (Regional Health Information Organizations) focused on electronic medical records. They are being worked as part of a special initiative in Atlanta, and some are being denied based on advice from EO Technical.

In determining whether non-hospital healthcare organizations qualify as organizations described in IRC section 501(c)(3), a “flexible community benefit standard” derived from Rev. Rul. 65-545 must be applied.

Clinic to Aid Drug Victims

- Rev. Rul. 70-590, 1970-2 C.B. 116, provides exemption to an organization operating a clinic to aid victims of hallucinatory drugs and disseminating information concerning such drugs. It operates a drug rescue center staffed by volunteer counselors experienced in dealing with drug abuse, maintains a 24-hour telephone crisis service and provides speakers to local high schools to speak on the problem of drug abuse.

Rural Health Center

- Rev. Rul. 73-313, 1973-2 C.B. 174, provides exemption to an organization that was formed by residents of an isolated rural community to provide a medical building and facilities at a reasonable rent to attract a doctor who would provide medical service to the entire community. Although it was understood that the doctor would be professionally independent and would charge for his services, the doctor agreed to treat patients requiring emergency care and, within reasonable limits on his time, to provide services for those unable to pay.

Continued on next page
Other Healthcare Organizations (continued)

Home Health Care
- Rev. Rul. 72-209, 1972-1 C.B. 148, provides exemption to a home health agency formed to provide low cost home health care for people of a community.

Medical Information Retrieval System
- Rev. Rul. 75-197, 1975-1 C.B. 156, provides exemption to an organization that operates a free computerized donor authorized retrieval system to facilitate transplantation of body organs upon a donor’s death.

Blood Bank
Prevention of Cruelty to Children or Animals

Children

The prevention of cruelty to children is specifically named as a purpose under IRC section 501(c)(3). This purpose is deemed to be charitable.

Hazardous Occupations and Unfavorable Working Conditions

- Rev. Rul. 67-151, 1967-1 C.B. 134, provides exemption to an organization formed to protect children from working at hazardous occupations in violation of state laws and in unfavorable working conditions.

Instructor Notes

Give Hurricane Katrina example - organizations trying to put displaced animals into new homes were given the same expedite treatment as those helping find homes for people!

Animals

Although not specifically designated as a “charitable” purpose, the prevention of cruelty to animals is specifically named as a purpose under IRC section 501(c)(3).

Preventing the Birth of Unwanted Animals

- Rev. Rul. 74-194, 1974-1 C.B. 129, provides exemption to an organization that prevented the birth and eventual suffering of unwanted animals by subsidizing spaying or neutering for pet owners who otherwise could not afford the services.

Humane Treatment of Laboratory Animals

Amateur Sports Organizations

Types

Certain amateur athletic organizations may qualify for exemption under IRC section 501(c)(3) as:

- Charitable
- Educational or
- An organization which fosters national or international amateur sports competition

This lesson merely serves as an introduction to those amateur sports organizations applying as charitable. Lesson 12B describes those qualifying as educational or fostering national or international amateur sports competition. But depending on their purposes and method of operation, other amateur athletic organizations may qualify under subsections such as IRC section 501(c)(4), social welfare organizations, or IRC section 501(c)(7), social/recreational organizations. These subsections will be discussed in Unit 1b.

Furthermore, certain amateur athletic organizations simply may not qualify for exemption, such as if they are serving substantial private interests.

Amateur Sports as a Charitable Activity

Regulating a Sport for Youth

- Rev. Rul 80-215, 1980-2 C.B. 124, holds that an otherwise qualifying organization that is formed to develop, promote, and regulate a sport for individuals under 18 years of age by organizing local and statewide competitions, promulgating rules, organizing officials, presenting seminars, distributing a newsletter, and otherwise encouraging growth of the sport qualifies for exemption under IRC section 501(c)(3).

Organizations created for the purpose of promoting sports for children have been upheld as charitable on the basis of combating juvenile delinquency.
Testing for Public Safety

Instructor Notes

Testing for public safety is also a higher-graded issue (Grade 12).

Instructor Notes

Foundation classification is section 509(a)(4) – but the class has not been introduced to foundation status yet.

Explain that the testing cannot be conducted on behalf of a specific company (for example, testing for pharmaceutical companies – this is normally expensed as research and development).

This is actual testing for public safety, not just promoting public safety (not just firefighters teaching fire safety).

Testing Products

Treas. Reg. 1.501(c)(3)-1(d)(1)(i)(d) provides that the testing of consumer products, such as electrical products, to determine whether they are safe for use by the general public is included in the term testing for public safety.

Safety Standards for Pleasure Boats


Instructor Notes

Explain that contributions to an organization that is testing for public safety are not deductible by the donor.

Using Document 6379 show students where to find the deductibility code that will be input on EDS.

Continued on next page
Testing for Public Safety, Continued

<table>
<thead>
<tr>
<th>Contributions</th>
<th>Not Deductible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treas. Reg. 1.170(c)(2) provides for the deductibility of contributions by donors to organizations described in IRC section 501(c)(3). This section of the regulations, however, makes no provision for the deductibility of contributions to those organizations testing for public safety.</td>
<td></td>
</tr>
</tbody>
</table>
Class Exercise

1. List three examples of charitable purposes specified in the Regulations:

   **Answer:** relief of the poor and distressed or of the underprivileged; advancement of religion, education, or science; erection of public buildings, monuments or works; lessening the burdens of Government; promotion of social welfare by organizations designed to accomplish one of the aforementioned purposes; lesson neighborhood tensions; eliminate prejudice and discrimination; defense of human and civil rights secured by law; combating community deterioration or juvenile delinquency

2. List three charitable classes:

   **Answer:** Elderly, Poor, Handicapped, Distressed, Youth (under the age of 18)

3. The elderly are generally considered to be a charitable class because of special needs. Which of the following is **not** a reason they are considered charitable?

   (a) Need for housing  
   (b) Poverty  
   (c) Need for health care  
   (d) Need for financial security

   **Answer:** (b)

4. In order to qualify for exemption, a transitional housing organization must provide services to low-income or elderly individuals

   (a) True  
   (b) False

   **Answer:** False  
   Transitional or temporary housing must be provided in a charitable manner to qualify for exemption. There are no specific charitable class requirements.
Class Exercise, Continued

5. Amateur sports organizations may qualify for IRC section 501(c)(3) exemption under three different purposes. Name the three exempt purposes under which they may qualify.

   Answer: Educational, charitable (combating juvenile delinquency), fostering national or international amateur sports competition

6. Provide a revenue ruling or other precedent that could apply to each of the following scenarios:

   (a) An organization set up to run errand for elderly persons, including buying groceries, taking them to doctor’s appointments, and mowing grass for them. The organization charges $2.00 for each service performed. No one is denied for inability to pay.

   Answer: Rev. Rul. 77-246

   (b) An organization was formed to help find buyers in the United States for beaded necklaces made by homeless women in Mexico.

   Answer: Rev. Rul. 68-167 or 68-117

   (c) An organization formed to test the durability of all playground equipment in their community.

   Rev. Rul. 65-61

   (d) An organization was formed to operate an animal shelter for abandoned or abused animals.

   Answer: Rev. Rul. 74-194

   (e) An organization was formed to provide free dental services to homeless people.

   Answer: Rev. Rul. 70-590

Continued on next page
Class Exercise, Continued

(f) An organization that operates a day care for children between the ages of six weeks and six years. They have 21 children at the center. All of their parents work in New York City.

   Answer: Rev. Rul. 68-166 or 70-533

(g) An organization set up to provide transitional care on an out-patient basis to cancer patients who have undergone chemotherapy.

   Answer: Rev. Rul. 72-16 or 79-17
Summary

Treas. Reg. 1.501(c)(3)-1(d)(2) provides that the term “charitable” is used in IRC section 501(c)(3) in its generally accepted legal sense and lists examples of purposes which are charitable in the legal sense.

Relief of the poor, distressed, or underprivileged is a charitable purpose that can take many forms including meeting the basic human needs of food, shelter, and clothing.

The elderly are generally recognized as a charitable class. Organizations that satisfy the needs of the elderly can be charitable as relieving the poor, distressed, or underprivileged. Generally the age of 62 is the cutoff to include individuals in a charitable class by reason of being elderly.

Assisting the Sick or Handicapped may be a charitable activity since the organization is relieving the burdens of the poor, distressed, or underprivileged.

Many organizations further such charitable purposes by operating transitional or temporary housing programs. The most commonly seen applications of this nature offer housing to individuals such as ex-convicts, recovering drug addicts, battered women, pregnant teenagers and the homeless. Much like food, clothing and medical assistance, shelter is considered a basic necessity of life.

Promotion of health is a charitable activity and is most commonly associated with the operation of a hospital but also includes rural and small medical clinics and other health related activities.

The prevention of cruelty to children and animals is specifically named as a purpose under IRC section 501(c)(3).

Amateur sports may qualify for exemption under IRC section 501(c)(3) if they are educational or charitable in nature.

Testing for public safety may be exempt under section 501(c)(3) however donations to these organizations are not deductible.
# Chapter 11

## Religious Organizations and Churches

### Instructor Preparation

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>5 hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference Materials</td>
<td>• Course book</td>
</tr>
<tr>
<td>Training Aids</td>
<td>TA 11-1, Objectives</td>
</tr>
<tr>
<td>Notes to Instructor</td>
<td>Create a flip chart of the <em>Objectives</em> to display throughout the chapter, or create a transparency using TA 11-1.</td>
</tr>
</tbody>
</table>
Chapter 11
Objectives

After completing this chapter you will be able to:

• Identify churches, church related organizations, and religious organizations

• Identify IRC Section 7611 limitations on the scope of examinations

• List the criteria used to determine whether an organization is a church
• Identify church related organizations
• Recognize other types of religious organizations that may qualify for exemption
• Determine whether religious publishing and broadcasting activities qualify for exemption
• Describe IRC section 7611 limitations on the scope of church examinations
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Chapter 11
Religious Organizations and Churches

Overview

Introduction
Organizations organized and operated exclusively for a religious purpose may qualify for exemption under IRC section 501(c)(3) of the Code.

Neither the statutes nor the regulations define “religious.”

Organizations claiming to be a church are not required to file Form 1023 – they are statutorily exempt. However, in order to receive a letter stating that the church is exempt, it must file Form 1023. The burden of proving that an organization is not a church rests on the Service. Churches are not required to file an annual Form 990.

A church automatically qualifies as a public charity under IRC sections 509(a)(1) and 170(b)(1)(A)(i). Other types of religious organizations generally qualify as public charities under IRC sections 509(a)(1) and 170(b)(1)(A)(vi), 509(a)(2) or 509(a)(3).

All organizations exempt under IRC section 501(c)(3) of the Code, including religious organizations and churches, are subject to the prohibition on inurement and private benefit.

Continued on next page
Overview, Continued

Objectives

After completing this chapter you will be able to:

• Identify churches, church-related organizations, and religious organizations

• Identify IRC section 7611 limitations on the scope of examinations

• List the criteria used to determine whether an organization is a church

• Identify church related organizations

• Recognize other types of religious organizations that may qualify for exemption

• Determine whether religious publishing and broadcasting activities qualify for exemption

• Describe IRC section 7611 limitations on the scope of church examinations

Continued on next page
Overview, Continued

This chapter contains the following topics:

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<th>Topic</th>
<th>See Page</th>
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</thead>
<tbody>
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<td>Overview</td>
<td>11-1</td>
</tr>
<tr>
<td>What Is a Church?</td>
<td>11-4</td>
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<tr>
<td>Churches With Fewer Than 20 Members</td>
<td>11-9</td>
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<tr>
<td>Non-Traditional Churches</td>
<td>11-13</td>
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<tr>
<td>Conventions or Associations of Churches</td>
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<tr>
<td>Church-Related Organizations</td>
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<td>Religious Organizations</td>
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<tr>
<td>Evangelistic Organizations</td>
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<tr>
<td>Religious Publishing and Broadcasting</td>
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<td>IRC section 7611</td>
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<tr>
<td>Summary</td>
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<tr>
<td>Exhibit 11-2: Attachment to Form 6038 for Church</td>
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</tr>
<tr>
<td>Exhibit 11-3: Revenue Procedure 96-10</td>
<td>11-43</td>
</tr>
</tbody>
</table>
What Is a Church?

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distinguish classification as a public charity as a church from exemption under section 501(c)(3).</td>
</tr>
<tr>
<td>• Exhibit 11-1: American Guidance Foundation vs. U.S</td>
</tr>
<tr>
<td>• The guidelines used in determining a church are found in the case of <em>American Guidance Foundation vs. U.S</em></td>
</tr>
<tr>
<td>• Give examples of each characteristic and explain fully.</td>
</tr>
<tr>
<td>• Go over Schedule A with students. Point out questions on application that lead to the completion of Schedule A.</td>
</tr>
</tbody>
</table>

*Continued on next page*
What Is a Church?, Continued

Characteristics

A church is one type of religious organization. Churches have their own public charity status under IRC sections 509(a)(1) and 170(b)(1)(A)(i).

There is no clear definition as to what a church is or should be. The court in American Guidance Foundation v. U.S., 490 F. Supp. 304 (D.C.D.C. 1980) (Exhibit 11-1), lists 14 criteria to consider for church classification under IRC sections 509(a)(1) and 170(b)(1)(A)(i). All or some of the following criteria should be present:

- A distinct legal entity
- A recognized creed and form of worship
- A definite and distinct ecclesiastical government
- A formal code of doctrine and discipline
- A distinct religious history
- A membership not associated with any other church or denomination
- A complete organization of ordained ministers ministering to their congregations
- Ordained ministers selected after completing prescribed courses of study

Continued on next page
What Is a Church?, Continued

<table>
<thead>
<tr>
<th>Characteristics (continued)</th>
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</tr>
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<tbody>
<tr>
<td>Literature of its own</td>
<td></td>
</tr>
<tr>
<td>Established places of worship</td>
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<tr>
<td>Regular congregations</td>
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<tr>
<td>Regular religious services</td>
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<tr>
<td>Sunday schools for the religious instruction of the young</td>
<td></td>
</tr>
<tr>
<td>Schools for the preparation of its ministers</td>
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</tr>
</tbody>
</table>

Court approach

In cases where church status has been litigated, the courts have more heavily weighted certain criteria. The following factors are considered to be especially important:

- A membership not associated with any other church or denomination
- Established places of worship
- Regular religious services

Benefits of Exemption as a Church

A church is not required to file a Form 990.

There are restrictions placed on the Service for any examination of an organization claiming to be a church.

Continued on next page
## What Is a Church? Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that many churches start off small and may have only family members on the board. Requests can be made for board expansion to ensure there is no inurement or private benefit.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Introduce Rev. Rul. 81-94</td>
</tr>
<tr>
<td></td>
<td>• Refer students back to Exhibit 11-2: Church Worksheet</td>
</tr>
<tr>
<td></td>
<td>• Explain that this worksheet is included in the case file as a work paper when the case is closed.</td>
</tr>
<tr>
<td></td>
<td>• Have students access the worksheet electronically.</td>
</tr>
</tbody>
</table>

### Considerations During Determination of Church Status

- Request research if there is reason to believe the church applicant may already be exempt under a group ruling.
  - If the church is already exempt under a group ruling, the user fee may be refunded; the church can request a copy of the group ruling letter by contacting its parent organization.
  - If the church is not part of a group ruling or requests an individual ruling letter, you will proceed with your determination as to whether it meets the legal requirements for church status.
- Organizations that claim church status whose family members control the organization often require additional scrutiny.
  - Control by family members increases the possibility for inurement.

*Continued on next page*
What Is a Church?, Continued

Court Approach (continued)

- If this is the case, the organization should be encouraged to expand the Board of Directors to include non-family members in the decision making process.

- Not all churches are the same. Consideration for church status must be given to churches with fewer than 20 members as well as non-denominational or non-traditional churches.

- Applications from churches whose activities are conducted solely on the internet are higher graded cases and are forwarded to EO Technical for processing per IRM 7.20.1.4.1(15)

- When closing a case, in addition to completing the required closing documents, a Church Worksheet should be completed and included in the case file as a work paper (see Exhibit 11-2). Required closing documents are discussed in Lesson 17, Case Closing.
## Churches with Fewer Than 20 Members

| Instructor Notes | Explain why churches with fewer members may or may not qualify as churches – may be better classified as religious organizations although many are found to qualify for church classification  
| Explain that there may be more developmental issues when dealing with a small church rather than a larger established church, many of them relating to private benefit or inurement |

| Churches With Fewer Than 20 Members | The qualifications for church status using the 14 Points are the same for all churches regardless of the number of members or the beliefs that are held. However, small churches may require more in depth development to ensure all legal requirements are met and that there is no inurement or prohibited private benefit.  
| If it is determined that the organization does not meet the requirements for church classification at the time of application but otherwise qualifies for exemption under IRC section 501(c)(3), an alternative foundation classification may be suggested to the applicant. For example:  
| Based on the information submitted this far, it does not appear that your organization will qualify as a church described under sections 509(a)(1) and 170(b)(1)(A)(i) of the Code. Since it appears that your primary activities are __________ you may be better classified as a publicly supported religious organization under sections 509(a)(1) and 170(b)(1)(A)(vi) or 509(a)(2) of the Code. |

*Continued on next page*
# Churches with Fewer Than 20 Members, Continued

## Instructor Notes

Explain that in *De La Salle Institute* church activities were found to be an incidental part of its overall activities. However, there are no specific guidelines as to what qualifies as “incidental”.

## Developmental Issues

### Regular Religious Services

While there is no set rule for the regularity of religious services, the applicant should establish that the church offers some type of regularly scheduled religious services.

Worship services held any less frequently than once a month should probably draw special scrutiny from the specialist to investigate why the organization feels no need to hold more regularly scheduled services and what activities they are conducting between services. Refer to *De La Salle Institute v. U.S.*, 195 F. Supp. 891 (N.D. Cal. 1961), for a discussion of “incidental” church activities.

## Instructor Notes

Explain that frequently, services are held in the home of the pastor or a member. This may be a source of private benefit or inurement if rent is paid. Explain that if services are held in a private residence, it must be determined how or if it is made available to the general public.
Churches with Fewer Than 20 Members, Continued

**Developmental Issues**

**Established Place of Worship**

Determine where services are held and whether the facility is reasonably available to the public. In some cases, this can potentially be a major source of private benefit/inurement. The specialist should ask questions such as the following:

- Who holds title to the facility?
- Is the owner related to an officer or director of the church?
- Is the organization leasing or purchasing the facility?

Additional developmental questions may be necessary pending the response of the organization.

If an organization has no regular place of worship or one that is not entirely suitable, consider the following:

- What steps is it taking to locate a permanent facility?
- Will the facility accommodate the congregation?

If the organization has no plans to acquire a facility, you should pursue its reason.

**Instructor Notes**

Discuss factors to consider:

Can a small, limited number of people actually be considered a congregation; Do many attend the services, but only a few are members; how diverse is the congregation; how many members are related by blood or marriage; do the members share sincere beliefs.

Discuss American Guidance Foundation and Spiritual Outreach Society v. Commissioner (927 F. 2d 335)

Continued on next page
The question concerning a regular congregation is often the most difficult to document for small churches. An unrelated membership and a genuine effort to recruit new converts may be considered when determining the foundation classification of a small church.

All factors need to be considered when determining whether a regular congregation exists, including religious restrictions and the following of a particular religion. Although we cannot require an organization to expand its congregation, a lack of recruitment efforts should be developed for possible qualification under a non-church foundation classification.

Determine how potential worshippers are made aware of the availability of the religious services. How, if at all, are they encouraged to attend? Possible marketing tools include permanent signs, newspaper ads, flyers/brochures, leaflets and street evangelism.

Facts and circumstances to consider when reviewing this information are the general practices of the religion with respect to recruiting or seeking new converts as well as whether the church serves a special population, for example, speakers of a particular foreign language, residents of a prescribed location, etc.

An unwillingness to promote its services could indicate that the organization doesn’t really want anyone to attend, or services held in a private home of an officer and promoted by word of mouth could indicate a problem, especially if the majority of the congregation is related.

Determine who is actually conducting the services. While there are no defined requirements for qualification as a church leader, most organizations have some type of definition of their own. The specialist should determine if the organization actually has a church leader and how this person meets any qualification requirements established by the church. Lack of a qualified leader should be considered when determining whether the organization qualifies as a church.
Non-Traditional Churches

Instructor Notes
This section will provide an example of a non-traditional church and suggestions for case development to determine if the organization is religious in nature and qualifies for church classification.

Background
Congress provided little guidance on the meaning of "church" when it excluded churches from the unrelated-business income tax and extended special charitable deduction privileges to churches. The current regulations under IRC section 170 do not define "church."

IRM 7.26.2.2(2) states "Few terms in the Code have proven as difficult to define, and as fraught with controversy, given the First Amendment's prohibition against government establishment of a religion or interference with the free exercise of religion."

An analysis of the First Amendment to the Constitution of the United States indicates that it is logically impossible to define “religion.” It appears that the two religious clauses of the First Amendment define “religious freedom” but do not establish a definition of “religion” within recognized parameters. The judicial system has struggled with this philosophic problem throughout the years in a variety of contexts.

Currently, court opinions provide most of the guidance on the meaning of "church."

As it is difficult to specifically define “non-traditional churches,” this section is designed to assist with an analysis of whether a "non-traditional church" conducts activities that are considered “religious” within the meaning of IRC section 501(c)(3), regardless of its beliefs.

Continued on next page
Non-Traditional Churches, Continued

Instructor Notes

Review that GCM cannot be used for law but may provide insight and other law references for making the determination.

GCM 36993

General Counsel Memorandum 36993, issued February 3, 1977 provides an example of the analysis used to determine whether an organization's activities are considered “religious” within the meaning of IRC section 501(c)(3) and whether the organization qualifies as a “church” for purposes of IRC section 170(b)(1)(A)(i). The facts of the case are presented below.

Case Facts

The organization is incorporated as a nonprofit religious organization. The purpose of the organization is to promote its religious beliefs by worshiping its recognized deities, to train priests, priestesses, and other leaders, and to instruct its members in the history, philosophy, and other components of the religion.

Members of the organization consider themselves pagans engaged in the practice of witchcraft. The organization has published a pagan manifesto, which sets forth standards of behavior for its followers. In the manifesto the members are urged to live according to the laws of nature.

The organization holds weekly services following a set ritual. There are also seasonal festivals and marriage ceremonies. The file does not show whether these ceremonies are recognized as valid marriages under applicable state laws. The organization's members worship ‘the horned god,’ but it is specifically alleged that this horned god is not the devil. Magic, healing, and clairvoyance are practiced and certain animals and plants are sacred to the organization's members.

Continued on next page
Non-Traditional Churches , Continued

Instructor Notes

Emphasize that there is no definition of “religion” only the requirement that the members are sincere in their beliefs. We cannot question the validity of the beliefs themselves.

Case Analysis

Is this organization conducting activities that are considered “religious” within the meaning of IRC section 501(c)(3), and what factors should be considered in making this determination?

The primary issue is whether the organization, whose members consider themselves to be “pagans engaged in the practice of witchcraft,” may be said to be “religious” as used in IRC section 501(c)(3).

Based upon several holdings, the GCM relied upon the following test regarding "religious beliefs:"

- A sincere and meaningful belief which occupies a place in life of its possessor parallel to that filled by orthodox belief in God is, in effect, a religious belief.

- In the absence of a clear showing that the beliefs or doctrines under consideration are not sincerely held by those professing or claiming them as a religion, the Service cannot question the “religious” nature of those beliefs.

Continued on next page
Applying the test, the GCM concluded on the basis of the evidence available in the administrative file that:

- the organization's members are sincere in their beliefs;
- the organization is organized and operated exclusively for the claimed purposes; and
- there is no evidence that its organizational documents authorize it to engage in, or that it in fact engages in, activities that are illegal or contrary to any clearly defined public policy.

Accordingly, and on the assumption that it otherwise qualifies, the GCM found that the organization qualified for recognition of exemption under IRC section 501(c)(3) as a religious organization.

Discuss situations such as organizations that “worship” at or during sporting events (i.e. Sunday football tailgating as religious services) and apply for exemption as churches and how to develop such requests.

When examining an organization claiming a religious character such as the organization in the above case, analyze the sincerity of "religious beliefs." IRM 7.25.3.6.4(1) states "In making a determination whether a religious organization qualifies for exemption under IRC 501(c)(3), the Internal Revenue Service cannot pass judgment on the merits of the applicant's asserted religious belief."
Non-Traditional Churches, Continued

Case Development (continued)

In *Welsh v. United States*, 398 U.S. 33 (1970), the Court states that "[i]f an individual deeply and sincerely holds beliefs that are purely ethical or moral in source and content but that nevertheless impose upon him a duty of conscience to refrain from participating in any war at any time, those beliefs certainly occupy in the life of that individual a place parallel to that filled by... God in the lives of traditionally religious persons." Thus, religious beliefs include many beliefs (for example, Taoism, Buddhism, and Secular Humanism) that do not posit the existence of a Supreme Being in the conventional sense.

While we cannot pass judgment on the organization's religious beliefs, we must carefully analyze its activities to determine whether it meets the operational test under IRC section 501(c)(3). (See IRM 7.25.3.6.6(1))

Instructor Notes

Review listed examples. Have class look up and read court cases if time allows.

Examples of Activity Development

The following are examples of issues that may apply to non-traditional churches, followed by court cases that denied or upheld denial of exemption under IRC section 501(c)(3).

Is the organization organized and operated exclusively for religious, charitable, or educational purposes?

- *Puritan Church of America*, 10 T.C.M. 485 (1951) – The Tax Court held that an organization dominated by one individual was not exempt as a religious organization because its purpose was to carry on the founder's personal feud with a local newspaper.

Continued on next page
Non-Traditional Churches, Continued

Examples of Activity Development (continued)

Does the organization conduct political or legislative activities?

- *Christian Echoes National Ministry, Inc. v. U.S.*, 470 F.2d 849 (10th Cir. 1972) – The court ruled that religious organizations that engage in substantial legislative activity are disqualified from tax exemption regardless of the motivation or purpose of that activity.

Are the organization's activities commercial in nature?

- *Living Faith v. Commissioner*, 950 F.2d 365 (7th Cir. 1991) – The court denied exemption to an organization that operated vegetarian restaurants and health food stores in a manner consistent with the religious beliefs of the Seventh-Day Adventist religion because its operations evidenced a substantial nonexempt commercial purpose.

Do activities involve inurement or private benefit?

- *The Founding Church of Scientology v. United States*, 412 F.2d 1197 (Ct. Cl. 1969), cert. den., 397 U.S. 1009 (1970) – The court, without considering the organization's beliefs, held that it did not qualify for exemption under IRC section 501(c)(3) because its net earnings inured to the organization's founder and members of his family.

Are activities illegal or contrary to clearly defined public policy?

- *Reynolds v. United States*, 98 U.S. 145 (1878) – The Court upheld a law passed by Congress that made the practice of polygamy by persons residing in United States territories a crime. In holding that religious belief did not except persons from operation of the statute, the Court said: "While they [laws] cannot interfere with mere religious belief and opinions, they may with practices."

Continued on next page
Non-Traditional Churches, Continued

Instructor Notes

Review application of 14 Points

Church Status

Once it is determined that an organization is organized and operated for “religious” purposes within the meaning of IRC section 501(c)(3), the application of the 14 Points can be used to determine whether a non-traditional church qualifies under IRC section 170(b)(1)(A)(i) as a church or whether another foundation classification is appropriate.
## Conventions or Associations of Churches

**Instructor Notes**

There are certain types of organizations affiliated with churches are also exempt by law without having to submit a Form 1023.

Explain that if the students have an organization that appears to be a convention or association of churches, they should discuss it with their manager for possible upgrade/reassignment.

---

**Introduction**

Conventions or associations of churches are another type of religious organization.

Conventions and associations of churches are considered to be automatically exempt as a public charity in the same manner as a church described above. However, if they wish to receive a determination letter, they must file Form 1023.

Like churches, they are classified as public charities under IRC sections 509(a)(1) and 170(b)(1)(A)(i).

Conventions or associations of churches are Grade 12 cases.

**Instructor Notes**

Distribute copy of Rev. Rul. 74-224 or have students access electronically.

Explain the importance of representation on the board.

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*Continued on next page*
Conventions or Associations of Churches, Continued

Example of a Convention or Association of Churches

A convention or associations of churches generally refers to the central association or convention of a group of churches or to an organization of churches of differing denominations.

Rev. Rul. 74-224, 1974-1 C.B. 61, holds that an organization that has a membership of churches of various denominations qualifies as an association of churches within the meaning of IRC section 170(b)(1)(A)(i).
Church-Related Organizations

Introduction

There are certain types of organizations that are affiliated with a church or convention or association of churches that are exempt under IRC section 501(c)(3) but are not classified under IRC section 170(b)(1)(A)(i). These organizations may be classified as public charities under IRC sections 509(a)(1) and 170(b)(1)(A)(vi), 509(a)(2), or 509(a)(3). These public charity statuses will be discussed at length later.

Instructor Notes

Have students research Code and Regulations to find section 6033.

Review and emphasize requirements for internally supported.

Integrated Auxiliary Defined

An integrated auxiliary of a church is defined in Treas. Reg. 1.6033-2(h)(1) as an organization that is:

- Described in both IRC section 501(c)(3) and either IRC sections 509(a)(1) and 170(b)(1)(A)(vi), 509(a)(2) or 509(a)(3)

- Affiliated with a church, or convention or association of churches, and

- Internally supported

Continued on next page
## Church-Related Organizations, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Give examples</th>
</tr>
</thead>
</table>

### Special Rule for Integrated Auxiliary

Treas. Reg. 1.6033-2(h)(5) lists the following organizations that do not have to meet the internal support requirement if they otherwise qualify as an integrated auxiliary:

- Men’s and women’s organizations
- Seminaries
- Mission societies
- Youth groups

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Exhibit 11-3: Revenue Procedure 96-10</th>
</tr>
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</table>

### Form 990 Filing Requirements

Rev. Proc. 96-10, 1996-1 C.B. 577 (Exhibit 11-3) and Treas. Reg. 1.6033-2 describe a class of organizations, affiliated with a church or convention or association of churches, that are not required to file Form 990.

*Continued on next page*
### Instructor Notes

Explain that UBI will be covered more fully in Unit 1b, but that they need to be aware that churches are not exempt from filing Form 990-T.

<table>
<thead>
<tr>
<th>Unrelated Business Income (UBI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>While a church, convention or association of churches, or a church affiliated organization is not required to file a Form 990, it is required to file a Form 990-T in the same manner as any other exempt organization if it has UBI.</td>
</tr>
</tbody>
</table>
Religious Organizations

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Discuss the differences between a church and a religious organization. Have students review IRM 7.25.3.6.12</th>
</tr>
</thead>
</table>

**Church v. Religious Organization**

Although every church may be a religious organization, not every religious organization is a church. A religious organization may be distinguished from a church in a number of ways:

- It generally does not carry out “church” functions, for example, sacerdotal duties such as weddings, baptisms, and funerals
- It generally does not conduct regularly scheduled worship services, have a regular congregation or an established place of worship
- It does not meet requirements for classification as a convention or association of churches

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Give examples of types of organizations that would be religious organizations.</th>
</tr>
</thead>
</table>

**Continued on next page**
Religious Organizations, Continued

Common Religious Organizations

The following organizations would be considered religious organizations and not meet the definition of a church if they are separately organized and operated:

- Evangelistic organizations
- Religious schools (such as seminaries)
- Youth groups
- Men’s and women’s associations
- Mission societies
- Religious publishing houses

Instructor Notes


Other Religious Organizations

The following are examples of other organizations whose activities might qualify them for exemption as a religious organization:

- A religious broadcasting station
- An organization which operates a coffee-house which encourages religious conversation and discussions
- An organization that promotes and conducts religious travel tours or retreats to increase the knowledge of religion and religious beliefs
## Evangelistic Organizations

### Instructor Notes

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Give examples of typical evangelistic organizations.</th>
</tr>
</thead>
</table>

### Types of Evangelistic Organizations

Many organizations have no real intention of establishing a regular congregation or services. They often travel from place to place, attracting worshipers to their services. Types of evangelistic activities include traveling evangelists, musical evangelists, and television or broadcasting evangelists.

In order for any of these organizations to qualify for exemption, the content of the presentations or materials must be exclusively religious or educational.

Depending on the nature of the financial support attracted by these organizations, they will usually qualify under IRC sections 509(a)(1) and 170(b)(1)(A)(vi) or 509(a)(2). Funding for these organizations may come from gifts and contributions from those attending their services, admission fees, or the sale of items.

Like other applications, the specialist needs to be on guard for inurement and private benefit issues such as extravagant meals and lodging, personal use of automobiles or private jets, copyright issues, etc.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that content must be exclusively educational or religious. Discuss how these types of organizations would generally not meet the 14 points.</th>
</tr>
</thead>
</table>

Continued on next page
A lot of religious or evangelistic organizations will hold services with an audience larger than any one church facility could possibly hold. These services may be conducted at a regular time and at a regular place, and may be broadcast via television, radio, or a combination of both. Broadcasts can range from a small local radio station to a complex, potentially nationwide network of affiliated radio and TV stations. In order to qualify for exemption under IRC section 501(c)(3), the content of the programming must be exclusively religious or educational.

Services may resemble those held at what is considered to be a traditional church location, but they are actually live productions to be broadcast over the air on radio or TV. No actual congregation, or a very limited audience, is usually in attendance at the location where the service is being conducted. If the organization requests church classification under IRC sections 509(a)(1) and 170(b)(1)(A)(i), the facts and circumstances of the case should be considered in relation to American Guidance Foundation’s 14 church criteria.
Religious Publishing and Broadcasting

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that insubstantial publishing activities such as church bulletins and pamphlets generally do not require much scrutiny.</th>
</tr>
</thead>
</table>

**Religious Publishing Activities**

Some religious organizations fulfill their exempt purpose by distributing or redistributing written materials in order to spread their message. These types of activities will usually qualify for exemption under IRC section 501(c)(3) so long as they further religion and are not conducted in a fashion similar to commercial publishing.

Examples of religious publishing include a church newspaper, a magazine of a particular faith, books, articles, internet media, and pamphlets written by individuals and organizations.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Have students read and discuss Rev. Rul. 68-513.</th>
</tr>
</thead>
</table>

**Religious Broadcasting Activities**

An organization may also set up a TV or radio station to broadcast religious programming. In order to qualify for exemption, the content of this programming must be exclusively religious or educational. Also, it cannot contain more than an insubstantial amount of non-religious programming or be operated in a commercial manner.

*Continued on next page*
Religious Publishing and Broadcasting, Continued

**Paid Advertising**

If an organization has paid advertising, such as magazine advertisements or radio commercials, the activity should be developed to determine whether it is a substantial non-exempt activity which may preclude exemption or whether the revenue is subject to unrelated business income tax (UBIT). Information on unrelated business income will be discussed later in this training. Additional information on classifying paid advertising can be found in the 2002 CPE Text *UBIT: Current Developments* and Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain how payments of royalties or copyrights held by other than the organization may result in private benefit or inurement.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Discuss when copyrights held by others may not result in private benefit or inurement.</td>
</tr>
</tbody>
</table>

**Copyright and Royalty Issues**

The sale or distribution of copyrighted material may give rise to private benefit or inurement issues. If the copyright of a publication or other work is held in the name of the applicant, the presence of copyrights and royalties should not bar exemption. Copyrights held by other than the organization should be developed to determine if inurement or private benefit is present.

If the copyright is held in the name of an individual, the ideal solution is to have the copyright transferred to the applicant. If the individual will not transfer the copyright to the organization, this issue should be thoroughly developed to determine past, present, or future private benefit or inurement to the copyright holder.

The distribution or resale of materials bought from and copyrighted by unrelated third parties (for example, purchasing Bibles for distribution) is rarely a private benefit/inurement issue. However, if the distribution is done on an unusually large scale, there could be issues of commercialism.

*Continued on next page*
Copyright and Royalty Issues (continued)

Possible copyright case development scenarios:

- If no royalties have been paid or are planned to be paid, the specialist may request that the individual and the organization sign an agreement that the copyright holder will transfer all royalties paid to the organization.

If royalties paid to an individual resulted in inurement or substantial private benefit, the specialist may consider prospective exemption, effective as of the date of a royalty transfer agreement. If the copyright holder will not agree to transfer royalties and inurement or substantial private benefit has occurred, then the specialist will need to consider a denial of exempt status.

Instructor Notes

Compare and contrast activities conducted in a commercial v. non-commercial manner.

Non-Commercial Manner

Religious publishing and broadcasting activities must be conducted in a non-commercial manner in order to qualify for exemption under IRC section 501(c)(3).

Issues to be considered in determining a non-commercial manner of sale or distribution of material are:

- How are the prices of items determined?
- Are the prices determined at cost, below cost, or in a manner to generate a substantial profit?
- If the prices are calculated in order to generate a substantial profit, what does the applicant do with the profits?

Continued on next page
Religious Publishing and Broadcasting, Continued

Non-Commercial Manner (continued)

- Are the profits used to further a religious or charitable purpose, or are they simply used to expand the publishing empire?

- How are sales conducted, and by whom?

- Does the organization operate a mail order type of operation? Does it sell over the Internet?

- Does the organization operate a type of bookstore?

- Do the organization’s members stand on streets and distribute the organization’s literature?

- Are sales and other operations conducted primarily by volunteer labor?

All of these factors may be considered to determine if an organization is operating like a commercial entity.

| Instructor Notes | Have students look up and review a couple of examples of non-exempt holdings. |

Religious Publishing and Broadcasting Law

Religious publishing activities held to be exempt:


- Saint Germaine Foundation v. Commissioner, 26 T.C. 648 (1956)

- Unity School of Christianity, 4 B.T.A. 61 (1926), acq. VI-1 C.B. 120

- Pulpit Resource v. Commissioner, 70 T.C. 594 (1978)
Religious Publishing and Broadcasting, Continued

Religious Publishing and Broadcasting Law (continued)

Religious publishing activities held to be not exempt (generally citing the commercial nature of the operation):


Religious broadcasting activities held to be exempt:


IRC Section 7611

Churches may be examined but only under the procedures in this section. For that reason be cautious when granting exemption to an organization claiming to be a church.

Due to the sensitivity of separation of church and state, safeguards have been put in place to prevent potential interference by the government in church affairs. IRC section 7611 limits the scope of the examination of a church or a religious organization claiming to be a church to determining:

- If there is any liability for income tax
- If the claimed church status can be supported by facts

Have students find restrictions on church audits in the IRM.

The IRM (IRM 4.76.7) makes it clear that the restrictions in IRC section 7611 include an organization that directly claims to be a church or which the Service may infer to be a church. If it is unclear whether the organization claims to be a church, the question should be raised in the initial contact.

The Service should not disregard an organization’s claim to church status unless information in the Service’s possession establishes the claim to be frivolous. In such a case, the Service will obtain Counsel’s written opinion before making a determination that IRC section 7611 is not applicable and the claim of church status is frivolous.

The restrictions of IRC section 7611 do not apply to routine requests for information needed to process letter ruling requests, applications for exemption or foundation classification, or information identifying a church that will be used by the Service to update its Cumulative List of Tax Exempt Organizations (Publication 78). (IRM 25.5.8.3.1(4))

Continued on next page
Instructor Notes

Have students research Code to find section 7611.

Explain that careful consideration needs to be made prior to determining that a case is a church.

Examinations v. Determinations and IRC Section 7611

Remember that IRC section 7611 is applied to field examinations of organizations claiming church status under IRC section 170(b)(1)(A)(i).

Specialists need to use caution before granting exemption to a church and be certain it meets all of the legal requirements. The correct determination is critical because of the restrictions on examinations by field agents. Study the restrictions noted in IRC sections 7611(a) and 7611(b).

There are special circumstances in which the restrictions imposed by IRC section 7611 do not apply and an audit examination is allowed; however, bear in mind that church examinations are tightly controlled.

Class Exercises

Administer and go over answers to class exercises.

Class Exercises 11-1 and 11-2
Organizations organized and operated exclusively for a religious purpose may qualify for exemption under IRC section 501(c)(3) of the Code.

A church is one type of religious organization. Churches have their own public charity status under IRC sections 509(a)(1) and 170(b)(1)(A)(i). There is no clear definition as to what a church is or should be. *American Guidance Foundation v. U.S.*, 490 F. Supp. 304 (D.C.D.C. 1980) lists 14 criteria to consider for church classification under IRC sections 509(a)(1) and 170(b)(1)(A)(i).

Small churches may require more in depth development to ensure all legal requirements are met and that there is no inurement or prohibited private benefit.

A convention or association of churches generally refers to the central association or convention of a group of churches or to an organization of churches of differing denominations and may be classified under IRC sections 509(a)(1) and 170(b)(1)(A)(i).

Religious organizations are organizations that do not conduct church services but do further religious purposes. Evangelistic organizations conduct activities which include traveling from place to place, attracting worshippers to their services. In order for these organizations to qualify for exemption, the content of the presentations or materials must be exclusively religious or educational.

Some religious organizations fulfill their exempt purpose by publishing, distributing or redistributing written materials or broadcasting religious material in order to spread their messages. These types of activities will usually qualify for exemption under IRC section 501(c)(3) so long as they are exclusively religious or educational and are not conducted in a fashion similar to commercial publishing or broadcasting.

Due to the sensitivity of separation of church and state, safeguards have been put in place to prevent potential interference by the government in church affairs. IRC section 7611 limits the scope of the examination of a church or a religious organization claiming to be a church.

Civ. A. No. 79-2061

UNITED STATES DISTRICT COURT, DISTRICT OF COLUMBIA


May 22, 1980

MEMORANDUM AND ORDER

Plaintiff, American Guidance Foundation, Inc. ("AGF"), a non-stock non-profit corporation operating in Philadelphia, seeks to be declared a "church" for tax purposes. After four years of administrative controversy, the Internal Revenue Service ("IRS") rejected AGF's request, leaving it classified as a private foundation, see 26 U.S.C. § 509(a) (1976), but not as a church, see 26 U.S.C. § 170(b)(1)(A)(i) (1976). Having exhausted its administrative remedies, plaintiff is properly before the Court. 26 U.S.C. § 7428(a)(1)(B) (1976). Thorough briefs were submitted by the parties, and the Court also has reviewed a substantial administrative record.

AGF was organized under Pennsylvania law by Robert Seyfried in 1972. Originally chartered as an educational organization, it successfully sought IRS exemption under section 501(c)(3) of the Internal Revenue Code. In late 1974, plaintiff "became a church" by unanimous consent of its directors, who then included Mr. Seyfried, his wife, his mother, and his brother-in-law. Throughout its existence, AGF has consisted of Mr. Seyfried and at most five members of his immediate family. Since August, 1977, the only members have been Seyfried, his wife and their minor child. Mr. and Mrs. Seyfried are the sole directors and officers. Mr. Seyfried, who graduated from
Philadelphia College of the Bible in the 1950's and teaches in the Philadelphia school system, is presently plaintiff's one commissioned "Christian Worker." He "regularly ministers to the AGF congregation," through worship services conducted in the Seyfrieds' apartment.

Different tax consequences flow from being classified a church, as opposed to a religious or educational organization that is a private foundation. Private foundations face more stringent limitations regarding inter alia permissible sources of income, required distributions of funds, and recordkeeping and reporting obligations. See generally 26 U.S.C. §§ 170; 507-509; 6033; 6056 (1976 & Supp. II 1978). Because this action seeks only relief in the form of a declaratory judgment, the Court cannot explore such differential consequences here.

In its 1974 Articles of Amendment, AGF identified its purposes as follows:

- To be an independent church, as described by Section 170(b)(1)(A)(i) of the Internal Revenue Code of 1954, that, according to its insight, fosters verbally and/or nonverbally love of God everywhere with one's whole heart, soul, mind, and strength and love of one's neighbor as oneself (Mark 12:30, 31) according to the doctrines of the Holy Scriptures as found in the canonical books of the Old and New Testaments and as lawfully construed by its Board of Directors.
- AGF's code of doctrine and discipline is "contained in the Old and New Testaments." Record evidence as to the nature of plaintiff's tenets or creed is generalized and largely uninformative. Various AGF exhibits reveal an abiding interest in the quality of communications between people, their communication with God, and the nature of communication itself. Color television and videotape recordings are employed during worship services. The Christian Worker conducts conversational and silent prayer with AGF's congregation.
- AGF also advertises in the Philadelphia Yellow Pages and has a recorded religious message on telephone tape. Although AGF describes itself as an independent church whose membership is not associated with any other denomination, it shares its place of worship, its telephone, its members and directors, its minister, and its conduct of services with Family Church, an organization that has not sought tax-exempt status.

It is well to begin by stating what is not at issue. The IRS concedes that plaintiff is a religious organization, qualifying for exemption under sections 501(c)(3) and 509(a) of the Code. The benefits accruing from such a determination are not in jeopardy. Difficult issues involving what constitutes sincere religious belief or practice, and how to avoid enforcing religious orthodoxy through the tax laws need not be faced. The narrower question presented here is whether this religious organization qualifies as a "church," as that term has been construed by the Service and the courts.

Although it is settled that Congress intended a more limited concept for "church" than for the previously identified "religious organization," Congress has offered virtually no guidance as to precisely what is meant. See De La Salle Institute v. United States, 195 F. Supp. 891, 897-901 [**6] (N.D.Cal.1961); Chapman v. Commissioner of Internal Revenue, 48 T.C. 358, 361-63 (1967). Nor does a coherent definition emerge from reviewing the Service's
rulings or regulations, or the limited instances of judicial treatment. One court concluded after thorough review of the relevant statutes and regulations that what is a "church" must be determined in light of general or traditional understandings of the term. *De La Salle Institute v. United States*, supra, 195 F. Supp. at 903. Such understandings are not easily achieved for at least two reasons. There is no bright line beyond which certain organized activities undertaken for religious purposes coalesce into a "church" structure. And the range of "church" structures extant in the United States is enormously diverse and confusing. See generally Whelan, 'Church' in the Internal Revenue Code: The Definitional Problems, 45 Ford.L.Rev. 885 (1977).

Faced with the difficult task of determining whether or not religious organizations are in fact churches, the IRS has developed fourteen criteria which it applies on an ad hoc basis to individual organizations. n2 While some of these are relatively minor, others, e.g. the existence of an established congregation served by an organized ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code, are of central importance. The means by which an avowedly religious purpose is accomplished separates a "church" from other forms of religious enterprise. See *Chapman v. Commissioner of Internal Revenue*, supra, 48 T.C. at 367 (Tannenwald, J., concurring). At a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship. Unless the organization is reasonably available to the public in its conduct of worship, its educational instruction, and its promulgation of doctrine, it cannot fulfill this associational role.

The criteria applied are as follows:

1. a distinct legal existence
2. a recognized creed and form of worship
3. a definite and distinct ecclesiastical government
4. a formal code of doctrine and discipline
5. a distinct religious history
6. a membership not associated with any other church or denomination
7. an organization of ordained ministers
8. ordained ministers selected after completing prescribed studies
9. a literature of its own
10. established places of worship
11. regular congregations
12. regular religious services
13. Sunday schools for religious instruction of the young
14. schools for the preparation of its ministers.

Plaintiff fails to satisfy the standard. Mr. Seyfried and his wife pray together [*307] in the physical solitude of their home. They do not constitute a "congregation" within the ordinary meaning of the word. AGF has made no real effort to convert others or to extend its membership beyond the immediate Seyfried family. Its telephonic religious message hardly qualifies as dissemination of a creed or doctrine. Its "religious instruction" consists of a father preaching to his son. Its "organized ministry" is a single self-appointed clergyman. Its "conduct of religious worship" does not extend beyond the family dwelling, which is used primarily for non-religious purposes. Rather than ministering to a society of believers, plaintiff is engaged in a quintessentially private religious enterprise.

The sincerity of the Seyfrieds' own religious beliefs is unquestioned here. Although the record is far from clear in establishing a recognizable creed or formal discipline, the Court does not rely on such uncertainties. The Court also need not address the matter of AGF's dubiously independent status in view of its intimate relation to the Family Church.

Instead, AGF fails to qualify under the threshold indicia of communal activity necessary for a "church."

It is not enough that a corporation believes and declares itself to be a church. Nor is it sufficient that the applicant prepares superficially responsive documentation for each of the established IRS criteria. To hold otherwise would encourage sham representations to the IRS and result in adverse tax consequences to the public at large. In this instance, AGF does not employ recognized, accessible channels of instruction and worship. There is little if any evidence that it seeks to reach or serve a congregation. Private religious beliefs, practiced in the solitude of a family living room, cannot transform a man's home into a church.

For the foregoing reasons, defendant's motion for summary judgment is granted and plaintiff's motion for summary judgment is denied. The case is dismissed.

SO ORDERED.
Attachment to Form 6038 for Church

Specialist’s Name:
Date Prepared:
Organization’s Name:

Recommend exemption under IRC 501(c)(3) and 1.501(c)(3)-1(d) of the regulations as a church because the organization meets the minimum requirements as described in American Guidance Foundation, Inc. v. U.S., 490 F. Supp. 304 (D.D.C. 1980).

The organization possesses the following characteristics of a church and qualifies for classification under sections 509(a)(1) and 170(b)(1)(A)(i).

The checkmarks made in the boxes below indicate that a positive response on the church "Schedule A" was given.

<table>
<thead>
<tr>
<th>Sch. A, Line #</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1a</td>
<td>Recognized written creed and/or statement of faith.</td>
</tr>
<tr>
<td>1b</td>
<td>Form of worship is Click for options - Other:</td>
</tr>
<tr>
<td>2a</td>
<td>Formal code of doctrine and discipline</td>
</tr>
<tr>
<td>2b</td>
<td>Distinct religious history</td>
</tr>
<tr>
<td>2c</td>
<td>Literature of its own</td>
</tr>
<tr>
<td>3</td>
<td>Definite and distinct ecclesiastical government</td>
</tr>
<tr>
<td>4a, 9</td>
<td>Regular religious services and activities include:</td>
</tr>
<tr>
<td></td>
<td>- baptisms, weddings, funerals</td>
</tr>
<tr>
<td></td>
<td>- bible classes/Sunday school</td>
</tr>
<tr>
<td></td>
<td>- communion</td>
</tr>
<tr>
<td></td>
<td>- evangelistic services, including revivals</td>
</tr>
<tr>
<td></td>
<td>- ordinations</td>
</tr>
<tr>
<td></td>
<td>- prayer/preaching/worship</td>
</tr>
<tr>
<td></td>
<td>- reading of the scriptures</td>
</tr>
<tr>
<td></td>
<td>- singing of hymns</td>
</tr>
<tr>
<td></td>
<td>- other:</td>
</tr>
<tr>
<td>4b</td>
<td>Public made aware of services by Click for options - Other:</td>
</tr>
<tr>
<td>5a &amp; b</td>
<td>An established place of worship:</td>
</tr>
<tr>
<td></td>
<td>- church building</td>
</tr>
<tr>
<td></td>
<td>- commercial building</td>
</tr>
<tr>
<td></td>
<td>- residential housing</td>
</tr>
<tr>
<td></td>
<td>- other</td>
</tr>
<tr>
<td></td>
<td>Owned by Click for options - Other:</td>
</tr>
<tr>
<td>6, 7</td>
<td>Established congregation consisting of at least regular members.</td>
</tr>
<tr>
<td>8c</td>
<td>Membership not associated with any other church or denomination</td>
</tr>
<tr>
<td>10</td>
<td>School for religious instruction of the young</td>
</tr>
<tr>
<td>11a</td>
<td>Ordained religious leaders/ministers selected after completing a prescribed course of study</td>
</tr>
<tr>
<td>11b</td>
<td>School for the preparation of ordained ministers/religious leaders</td>
</tr>
<tr>
<td>13</td>
<td>Ministers/religious leaders ordained, commissioned, &amp;/or licensed by church</td>
</tr>
</tbody>
</table>

(Rev. 4-26-10)
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[Code Secs. 501 and 6033]

Information returns: Tax-exempt organizations.--The IRS has provided a class of organizations, affiliated with a church or convention or association of churches and exempt from income tax under Code Sec. 501(c)(3), that is not required to file an annual information return on Form 990, Return of Organizations Exempt From Income Tax. The organizations that are not required to file Form 990 include: (1) organizations that are operated, supervised, or controlled by one or more churches, integrated auxiliaries, or conventions or associations of churches and (2) organizations that are operated, supervised or controlled by one or more religious orders and are engaged in financing, funding, or managing assets used for exclusively religious activities. The procedure is effective for tax years beginning after December 20, 1995. Rev. Proc. 83-23 is supplemented, and Rev. Proc. 86-23 is obsoleted. BACK REFERENCES: 96FED P22,604.014, 96FED P36,625.0165, 96FED P36,625.14 and 96FED P36,625.23.

SECTION 1. PURPOSE

The purpose of this revenue procedure is to list a class of organizations, affiliated with a church or convention or association of churches and exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, that is not required to file an annual information return on Form 990, Return of Organizations Exempt from Income Tax. This revenue procedure supplements Rev. Proc. 83-23, 1983-1 C.B. 687, and obsoletes Rev. Proc. 86-23, 1986-1 C.B. 564.

SEC. 2. BACKGROUND

.01 Section 6033(a)(1) of the Code generally requires all tax-exempt organizations to file an annual information return on Form 990.

.02 Section 6033(a)(2)(A) of the Code provides certain mandatory exceptions to this filing requirement, specifically for churches, their integrated auxiliaries, and conventions or associations of churches.

.03 Section 6033(a)(2)(B) of the Code provides discretionary exceptions from filing such returns where the Secretary "determines such filing is not necessary to the efficient administration of the internal revenue laws." Section 1.6033-2(g)(6) of the Income Tax Regulations delegates authority to the Commissioner to excuse organizations from the filing requirement. It
provides that "the Commissioner may relieve any organization or class of
organizations from filing, in whole or in part, the annual information return
required by section 6033 where he determines that such returns are not
necessary for the efficient administration of the internal revenue laws."

.04 Section 1.6033-2(g)(1) of the regulations provides a partial list of
organizations that are not required to file annual returns either because they
are excepted by statute or because the Commissioner has exercised the
authority referred to above in Sec. 2.03. A more complete list is contained in

.05 A return filing exception for certain church-affiliated organizations
engaged exclusively in managing funds or maintaining retirement programs was
announced originally in Notice 84-2, 1984-1 C.B. 331. That exemption was
86-23 also defined what is an integrated auxiliary of a church for purposes of
the filing exception provided in section 6033(a)(2)(A). Treas. Reg.
§1.6033-2(h) now has incorporated the definition of integrated auxiliary of a
church, making Rev. Proc. 86-23 partially obsolete. Accordingly, this revenue
procedure replaces Rev. Proc. 86-23, preserving the filing exemption that
remains in effect for certain church-affiliated organizations that manage
funds and retirement programs and deleting those portions of Rev. Proc. 86-23
that are now part of the regulations. Some organizations exempted from filing
by this revenue procedure may also qualify as integrated auxiliaries exempt
from filing under section 6033(a)(2)(A).

SEC. 3. ORGANIZATIONS EXCUSED FROM FILING

.01 The following organizations will not be required to file Form 990:

(1) An organization described in section 501(c)(3) that is operated,
supervised, or controlled by one or more churches, integrated auxiliaries, or
conventions or associations of churches, and

(a) is engaged exclusively in financing, funding the activities of, or
managing the funds of

(i) a church, integrated auxiliary, or convention or association of
churches, or

(ii) a group of organizations substantially all of which are described in
(1)(a)(i), if substantially all of its assets are provided by, or held for
the benefit of, organizations described in (1)(a)(i); or

(b) maintains retirement insurance programs primarily for organizations
described in (1)(a)(i), and

(i) more than 50 percent of the individuals covered by the programs are
directly employed by those organizations, or

(ii) more than 50 percent of the assets are contributed by, or held for the
benefit of, employees of those organizations.
(2) An organization described in section 501(c)(3) that is operated, supervised or controlled by one or more religious orders and is engaged in financing, funding, or managing assets used for exclusively religious activities.

.02 For purposes of this revenue procedure, an integrated auxiliary is an organization that meets the definition contained in Treas. Reg. §1.6033-2(h).

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective for tax years beginning after December 20, 1995, the date of publication of final Treas. Reg. §1.6033-2(h) in the Federal Register.

SEC. 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 83-23 is supplemented. Rev. Proc. 86-23 is rendered obsolete as of the effective date set forth above in Sec. 4.

DRAFTING INFORMATION

The principal author of this revenue procedure is John Francis Reilly of the Exempt Organizations Division. For further information regarding this revenue procedure contact Mr. Reilly on (202) 622-7352 (not a toll-free call).
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Chapter 12
Lesson 12A

Educational Organizations

Instructor Preparation

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<td>Training Aids</td>
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<tr>
<td>Notes to instructor</td>
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Chapter 12
Lesson A
Objectives

After completing this chapter you will be able to:

• Define “education’ per Treas. Reg. 1.50(c)(3)-1(d)(3)

• Identify activities that qualify as ‘educational” per IRC Section 501(c)(3)

• Distinguish between exclusively educational activities and activities that qualify for exemption under other IRC subsections.
Chapter 12
Lesson 12A
Educational Organizations

Overview

Introduction

IRC section 501(c)(3) provides for the exemption of organizations organized and operated exclusively for “educational purposes.”

The term “educational” as an exempt activity under IRC section 501(c)(3) is very broad. Educational purposes go beyond those we traditionally think of as being performed in a formal setting of schools, colleges, and universities. Organizations operating in support of education are considered educational. The education of the public on various subjects is also considered educational.

This section assists you in identifying activities that qualify as “educational” by providing a definition of the term per IRC section 501(c)(3), outlining operational requirements, and analyzing activities that have educational and social aspects.

Objectives

After completing this chapter you will be able to:

- Define "education" per Treas. Reg. 1.501(c)(3)-1(d)(3)
- Identify activities that qualify as "educational" per IRC section 501(c)(3)
- Distinguish between exclusively educational activities and activities that qualify for exemption under other IRC subsections
Overview, Continued

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### Education Defined

*Treas. Reg. 1.501(c)(3)-1(d)(2)* defines the term “charitable” to include the advancement of education and the promotion of social welfare by organizations designed to combat community deterioration.

*Treas. Reg. 1.501(c)(3)-1(d)(3)(ii)* provides that the term educational includes:

- The instruction or training of the individual for the purpose of improving or developing his/her capabilities
- The instruction of the public on subjects useful to the individual and beneficial to the community

### Qualifications and Prohibitions

An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual of the public to form an independent opinion or conclusion.

Therefore, an organization is **not** educational if its principal function is the mere presentation of unsupported opinion.
IRC 501(c)(3) “Exclusively" Educational Requirement

As a determinations specialist, one of your principal responsibilities is to determine an applicant's primary purpose by examining their programs and activities. Frequently, there is a fine line between activities that qualify as educational and those that are primarily social. Subject matter has little to do with whether an organization is educating or amusing its members.

To qualify as an educational organization under IRC section 501(c)(3), the applicant must be organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

An accurate determination of whether an applicant qualifies for exemption and which code section is appropriate is made after the specialist has a complete understanding of the organization's primary purpose and the methods they will use to accomplish their purpose.

Instructor Notes

Have students access (or pass out) and read Rev. Rul. 66-179.

Rev. Rul. 66-179

Rev. Rul. 66-179, 1966-1 C.B. 139, uses the four situations discussed below to illustrate how an organization, depending on its form of organization and method of operation, may qualify for tax-exempt status as:

- charitable or educational organization described in IRC section 501(c)(3)
- civic organization described in IRC section 501(c)(4)
- horticultural organization described in IRC section 501(c)(5)
- social club described in IRC section 501(c)(7)
IRC 501(c)(3) Educational Activities

| Instructor Notes | Contrast these situations with situation #1. Explain that training on non-501(c)(3) subsections will be covered in Unit 1b. Emphasize why organization does not qualify for 501(c)(3) in each of the situations. |

**Situation 1: Exclusively Educational**

The organization was incorporated as a nonprofit organization for the purposes of instructing the public on horticultural subjects and stimulating interest in the beautification of the geographic area. In furtherance of these purposes, the organization conducts the following programs and activities:

- Maintains and operates a free library of materials on horticulture and allied subjects
- Instructs the public on correct gardening procedures and conservation of trees and plants by means of radio, television, and lecture programs
- Holds public flower shows of a noncommercial nature at which new varieties of plants and flowers are exhibited
- Makes awards to children for achievements in gardening
- Encourages roadside beautification and civic planting
- Issues awards for civic achievement in conservation and horticulture

Membership in the organization is open to the public and consists primarily of amateur gardeners and others not professionally or commercially connected with horticulture. The organization's funds are derived from donations and membership dues, fees, and assessments. No part of its net earnings inures to the benefit of any officer or member.

The organization is this situation qualifies for exemption under IRC section 501(c)(3) because it is operated exclusively for charitable and educational purposes.
Educational vs. Social / Horticultural Activities

**Situation 2**
**Social Activities**

The facts are the same as in Situation 1 except that a substantial part of the organization's activities, but not its primary activity, consists of social functions for the benefit, pleasure, and recreation of its members.

The facts in this Situation are distinguishable from those in Situation 1 in that the organization conducts substantial social functions not in furtherance of any of the purposes specified in IRC section 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as ‘operated exclusively’ for one or more exempt purposes described in IRC section 501(c)(3) if more than an insubstantial part of its activities is not in furtherance of an IRC section 501(c)(3) purpose.

The organization in this situation does not qualify for exemption under IRC section 501(c)(3). However the organization does qualify for exemption under IRC section 501(c)(4).

**Note:** In-depth discussion of IRC section 501(c)(4) will be presented in subsequent training.

**Situation 3**
**Horticultural Activities**

This organization was incorporated as a nonprofit organization for the purposes of bettering the conditions of persons engaged in horticultural pursuits and improving the grade of their products. In furtherance of these purposes, the organization publishes a monthly trade journal, reports periodically to its members any new developments in horticultural products, and encourages the development of better horticultural products through a system of awards.

The facts in this Situation are distinguishable from those in Situation 1 in that the organization's purpose is to better the conditions of persons engaged in horticultural pursuits and not to instruct the public on horticultural subjects. The membership of the organization is mainly composed of individuals and firms engaged in the business of horticulture and related fields.
Educational vs. Social / Horticultural Activities, Continued

**Situation 3**

**Horticultural Activities (continued)**

The organization in this situation does not qualify for exemption under IRC section 501(c)(3). However the organization does qualify for exemption under IRC section 501(c)(5).

**Note:** In-depth discussion of IRC section 501(c)(5) will be presented in subsequent training.

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**Situation 4**

**Social Activities**

The organization was incorporated by amateur gardeners to promote their common interest in gardening. The organization conducts the following programs and activities:

- Holds flower shows and exhibits to display members' achievements in home gardening
- Schedules weekly meetings devoted primarily to informal social hours during which matters related to gardening are discussed
- Issues a publication containing news about members' social activities and achievements in home gardening

Its funds are derived from membership dues, fees, and assessments. No part of the net earnings of the organization inures to the benefit of any officer or member. The organization, in carrying out its purposes in the manner described above, is being operated exclusively for pleasure and recreation of its members.

The facts in this Situation are distinguishable from those in Situation 1 in that the organization conducts substantial social functions not in furtherance of any of the purposes specified in IRC section 501(c)(3).

The organization in this situation does not qualify for exemption under IRC section 501(c)(3). However the organization does qualify for exemption under IRC section 501(c)(7).

**Note:** In-depth discussion of IRC section 501(c)(7) will be presented in subsequent training.
Professional or Business Organizations Conducting Educational Activities

Instructor Notes

Explain that educational activities do not need to be open to the general public to qualify for exemption. They only need to be exclusively educational.

Overview

As a general rule, professional or business organizations are organizations described as business leagues under IRC section 501(c)(6). However, a professional or business organization may conduct educational activities that qualify as exclusively educational under IRC section 501(c)(3).

The following three Revenue Rulings provide examples of such activities.

Note: In-depth discussion of IRC section 501(c)(6) will be presented in subsequent training.

Rev. Rul. 68-504

Rev. Rul. 68-504, 1968-2 C.B. 211, provides that a nonprofit organization formed to conduct an educational program for bank employees in a particular urban area was held to be exempt as an educational organization. The organization conducts the following programs and activities:

- The organization furnishes classrooms and employs local university professors and specialists in banking law to teach courses on various banking subjects. Credit is given by universities for hours spent in such work.

- The organization purchases textbooks for resale at cost to students.

- It also publishes a professional magazine containing items of interest and assistance to the members and conducts occasional social affairs to stimulate interest in its educational program. The social affairs involve an insubstantial part of the organization's activities.

The organization in this situation qualifies for exemption under IRC section 501(c)(3) because its activities are exclusively educational and the social activities of the organization are insubstantial in relation to its educational activities.

Continued on next page
Rev. Rul. 65-298, 1965-2 C.B. 163, provides that an organization conducting seminars for postgraduate education of practicing physicians was determined to be an educational activity. The organization conducts the following programs and activities:

- Seminars are presented in various cities using as speakers teachers from medical schools and outstanding specialists in private practice. The guest speakers are usually paid a nominal amount.

- The seminars and lectures are designated to lessen the time between the discovery of medical knowledge and its practical application. It is anticipated that medical research will later be undertaken.

- All results of this research (including any patents, copyrights, processes, or formulas resulting from such research) will be made available to the general public on a nondiscriminatory basis.

The organization in this situation qualifies for exemption under IRC section 501(c)(3) of the Code because the seminars and lectures presented relate to the instruction or training of the physicians attending them for the purpose of improving and developing their capabilities. Under such circumstances, the organization is engaged in an educational activity within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations.
Rev. Rul. 67-72, 1967-1 C.B. 175, holds that an organization created by labor and management to select individuals for apprentice training, arrange their classroom and on-the-job training was held to be an educational organization under IRC section 501(c)(3). Upon completion of the training the individual is qualified to seek employment as a journeyman anywhere in the industry. The organization has no other activities.

The organization in this situation qualifies for exemption under IRC section 501(c)(3) because the organization is assisting in the training of individuals for the purpose of improving or developing their capabilities.
Clubs Conducting Educational Activities

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Have students access (or pass out) and read Rev. Rul. 67-139.</th>
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</table>

Rev. Rul. 67-139

Rev. Rul. 67-139, 1967-1 C.B. 129, provides additional examples of how an organization may qualify for exemption under IRC sections 501(c)(3) or 501(c)(7) depending on its form of organization and methods of operation.

Rev. Rul. 67-139: Situation 1

The organization was formed to advance the earth sciences by stimulating interest and encouraging study of the same. It was comprised of amateurs and hobbyists interested in geological, mineralogical, and lapidary activities. In carrying out its purpose, the organization created the following activities:

- Held monthly lectures at which qualified experts discussed topics pertaining to gems and minerals
- Sponsored field trips to collect and study various kinds of rocks and minerals
- Issued a bulletin containing educational material pertaining to rocks and minerals
- Maintained a library of reference materials on geological, mineralogical, and lapidary subjects
- Assisted the local museum in its display of gems and minerals through specimens provided from members’ collections, and
- Conducted a show annually for the general public and displayed collections of gems and minerals

Continued on next page
The ruling noted the lectures, discussions, field trips, and shows conducted by the club, to which the general public is invited, are recognized as educational within the meaning of the regulations even though they serve recreational interests.

The organization is this situation qualifies for exemption under IRC section 501(c)(3) because they are operated exclusively for charitable and educational purposes.

**Instructor Notes**

Discuss why situation 2 does not qualify under 501(c)(3).

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**Rev. Rul. 67-139: Situation 2**

The organization was formed by mineralogy and lapidary enthusiasts to disseminate knowledge of mineralogical and lapidary subjects, to promote their application so that greater pleasure may be derived from these activities, and to promote good fellowship among its members. In furtherance of these purposes, the organization conducted the following activities:

- Held monthly social meetings during which the members discussed gem and mineral topics and sold, purchased, or exchanged rock and mineral specimens
- Issued a bulletin containing news of members’ social activities and their rock and mineral collections, and
- Annually conducted a show for the general public at which its members displayed their lapidary techniques and mineral specimens
The organization in Situation 2 provided a meeting place for its members where they could associate with each other and become more proficient in their hobbies. The gem and mineral show that served to stimulate the members’ hobby interests was consistent with the organization’s recreational purposes.

The facts in this Situation are distinguishable from those in Situation 1 in that the organization conducts substantial social functions not in furtherance of any of the purposes specified in IRC section 501(c)(3).

The organization in this situation does not qualify for exemption under IRC section 501(c)(3). However the organization does qualify for exemption under IRC section 501(c)(7).

Note: In-depth training on IRC section 501(c)(7) will be presented in a subsequent lesson.
Additional Examples of Clubs Conducting Educational Activities

<table>
<thead>
<tr>
<th>Educational vs. Social / Recreational</th>
<th>Chess Tournaments</th>
<th>Science Fiction Convention</th>
<th>Flying Club</th>
</tr>
</thead>
<tbody>
<tr>
<td>The organization in <em>Minnesota Kingsmen Chess Association, Inc. v. Commissioner</em>, 46 T.C.M. 1133 (1983), arranged chess tournaments for its members, provided chess magazines and books and offered instruction in and sponsored exhibitions of the game of chess. The court ruled that the organization did not qualify for exemption under IRC section 501(c)(3) because a substantial activity of the organization was the promotion and conduct of the tournaments, which were found to serve “recreational interests” of the members.</td>
<td>In <em>St. Louis Science Fiction Limited v. Commissioner</em>, 49 T.C.M. 1126 (1985), the court ruled likewise. The organization’s principal activity was an annual science fiction convention. The court concluded that the organization was not educational on the basis of its substantial “social and recreational purposes.”</td>
<td>In <em>Syrang Aero Club, Inc. v. Commissioner</em>, 73 T.C.M. 717 (1980), the court ruled that the organization was not educational and did not qualify for exemption under IRC section 501(c)(3) because with no classes or lectures, the organization was merely a flying club that provided members with an opportunity for unsupervised flight time.</td>
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Reviewing Form 1023

Important Items

When reviewing the information submitted by an applicant requesting exemption under IRC section 501(c)(3) as an educational organization be sure to carefully review the Form 1023 and all attachments to gain an understanding of the organization's primary purpose and the methods they will use to accomplish their purpose. Educational activities are often evidenced by:

- A structured educational program such as classes, seminars, workshops, etc.

- Distribution of educational materials such as newsletters, bulletins, use of documentation, library of reference materials, etc. and/or

- Instruction by qualified individuals such as credentials of scholarship or skill

Information relating to membership requirements, literature used to recruit members, and benefits to members often provide evidence of social or recreational activities. When applicable, review the applicant's website to determine the organization's true purpose.

Instructor Notes

Administer and go over answers to Class Exercise 12A-1.
Summary

The term “educational” as an exempt activity under IRC section 501(c)(3) is very broad. Educational purposes go beyond those we traditionally think of as being performed in a formal setting of schools, colleges, and universities. Organizations operating in support of education are considered educational. The education of the public on various subjects is also considered educational.

Treas. Reg. 1.501(c)(3)-1(d)(3)(ii) provides that the term educational includes:

- The instruction or training of the individual for the purpose of improving or developing his/her capabilities
- The instruction of the public on subjects useful to the individual and beneficial to the community

To qualify as an educational organization under IRC section 501(c)(3), the applicant must be organized and operated exclusively for charitable, religious or educational purposes. To determine if the organization is operated exclusively for educational purposes depends on the activities of the organization. Careful review of the activities is needed to determine the overall purpose of the activities. The amount of time the organization spends on social or networking activities may affect exemption under section 501(c)(3).

Educational activities are often evidenced by structured educational programs, distribution of educational materials, or instruction.
Chapter 12
Lesson 12B

Community Education Programs

Instructor Preparation

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<th>Estimated Time</th>
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<td>Training Aids</td>
<td>• TA 12B-1, Objectives</td>
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<td>Notes to instructor</td>
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Chapter 12
Lesson B
Objectives

After completing this chapter you will be able to:

• Distinguish between educations and commercial activities

• Discuss the four publishing criteria identified in Rev. Rul. 67-4
• Identify typical financial literacy programs and activities

• Identify community programs and activities that qualify as educational under IRC section 501(c)(3)
Chapter 12
Lesson 12B
Community Education Programs

Overview

Introduction

Treas. Reg. 1.501(c)(3)-1(d)(3)(i)(b) provides that the term “educational” for the purposes of IRC section 501(c)(3) relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

The Regulations provide the following examples of activities that are considered to be educational:

- An organization whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs such as radio or television broadcasting
- An organization that presents a course of instruction by means of correspondence or through the utilization of television or radio
- Museums, zoos, planetariums, symphony orchestras, and other similar organizations

This section explains the various methods used to educate the public including:

- Promotion of the arts
- Publishing
- Credit counseling
- Financial literacy
- Education of youth
- Other community educational activities

Continued on next page
Overview, Continued

Objectives
At the end of this lesson you will be able to:

- Distinguish between educational and commercial activities
- Discuss the four publishing criteria identified in Rev. Rul. 67-4
- Recognize typical financial literacy programs and activities
- Recognize community programs and activities that qualify as educational under IRC section 501(c)(3)

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<td>Exhibit 12B-1: Financial Literacy Checklist</td>
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</table>
“Promotion of the Arts – Commercial Type Activities

Promotion of the arts and literature has traditionally been recognized as an educational activity. Organizations exclusively dedicated to such pursuits are recognized as exempt under IRC section 501(c)(3).

Educational and commercial activities intersect in promotion of art and theater. Consequently, all commercial transactions, including the sale of art, must be examined closely to ensure that they are conducted in an educational manner and serve public rather than private interests.

There is a broad range of commercial activities that have generally been found to promote the arts in one form or another. Here is a brief summary of revenue rulings that identify programs considered “educational” as exempt under IRC section 501(c)(3):

- Rev. Rul. 64-175, 1964-1, (Part 1) C.B. 183 – promotion of theatrical productions

Continued on next page
“Promotion of the Arts – Commercial Type Activities, Continued

“Commercial” Activities Considered Educational (continued)


Note: This revenue ruling also provides guidance on how an organization can secure paid engagements for artists and still be considered educational.

Sale of Art as a “Commercial” Activity Not Considered Educational

Activities involving the sale of art should be carefully reviewed to ensure that there are no issues which may preclude exemption. The following revenue rulings provide examples involving the sale of artwork as a commercial activity and/or promoting private interests and were not considered educational. As such, the organizations do not qualify as exempt under IRC section 501(c)(3).

- Rev. Rul. 71-395, 1971-2 C.B. 228 – A cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting and selling their works does not qualify for exemption under IRC section 501(c)(3). The gallery was formed and is operated by a group of approximately 50 artists. Additional artists are admitted to membership by approval of the existing members. The gallery is open to the public six days a week. No admission is charged. Works of the member artists are exhibited and offered for sale. A panel chosen by the members selects those works for exhibition that in its opinion meet certain minimal artistic standards. Special showings by individual members are also held on a rotating basis. All works may be purchased by the public and many may be rented. The gallery retains a commission from sales and rental sufficient to cover the cost of operating the gallery. Any deficits that occur are covered by special assessments of the members.

Continued on next page
Promotion of the Arts – Commercial Type Activities, Continued

Sale of Art as a “Commercial” Activity Not Considered Educational (continued)

- Rev. Rul. 76-152, 1976-1 C.B. 151 – A group of art patrons formed an organization to promote community understanding of modern art trends. As its sole activity, the organization selects modern art works of local artists for exhibit at its gallery and for possible sale. The gallery is open to the general public. A modern art work of any local artist is eligible for consideration for exhibition. If selected, the artist’s work is displayed on a consignment basis with the artist setting the selling price. The artists have no control over the organization or its selection process. The organization retains a ten percent commission on sales. The commissions are substantially less than customary commercial charges and are not sufficient to recover the cost of operating the gallery. The organization attempts to make up operating deficits by soliciting contributions from the general public.

In both of the situations discussed above, the artists are being directly benefited by the exhibition and sale of their works. Both organizations primary purpose is to serve the private interest of their members, even though the exhibition and sale of paintings may be an educational activity in other respects.

Instructor Notes
Point out the sale of art was not the primary activity of the organization.

Case Study – Sale of Art May Not Preclude Exemption

In Goldsboro Art League v. Commissioner, 75 T.C. 337 (1980), the organization operates the Goldsboro Art Center which provides a variety of charitable and educational services to the community including workshops, art demonstrations, an educational film series, and a permanent collection of art for public display. In addition to its charitable and educational activities, Goldsboro operates two public galleries where artwork is displayed and offered for sale.

The Service held that the organization’s activities were indistinguishable from a commercial art gallery’s activities and denied exemption.

Continued on next page
The Tax Court disagreed, finding that the purpose of the art gallery and art market is primarily to foster community awareness and appreciation of contemporary artists and to provide a constant flow of art for students to study art and painting techniques. The court noted the circumstances surrounding the operation of the art gallery and art market as illustrating that the organization intends to educate rather than to sell.

The following factors were deemed important by the court:

- Scope and nature of the other activities are clearly educational
- There are no other art museums or galleries in the area
- The organization relies on volunteers for many of its activities
- A jury selects those works that are displayed
- Works are chosen not for salability but for their representation of modern trends
- An artist’s more daring works are exhibited
- Art sales were not conducted at a profit

The court believed that the sales activities were incidental to the organization’s other activities and served the same overall objective of art education. The sales activities were seen as secondary and incidental to furthering an exempt purpose. The court rejected the Service’s position that private individuals benefited by the sales activities.

The court also stated that the private benefit prohibited under IRC section 501(c)(3) did not flow to the artists whose works were sold since the artists did not control the jury selecting the works. The Service acquiesced to the decision of the court.

Continued on next page
The sale of art may give rise to an unrelated trade or business issue under IRC sections 511-513. A private letter ruling considered this issue.

Private letter ruling 8032028, dated May 5, 1980, describes an organization, exempt under IRC section 501(c)(3), whose main function is the operation of an art museum. The organization displays works of art that are available for rent or for sale.

The ruling holds that the sales of original art works do not contribute importantly to the accomplishment of the organization’s exempt purpose, which is to educate the public in art by displaying art works for public appreciation. Selling original art works detracts from the organization’s purpose since sold works are removed from public display. Thus, the art sales were held to be an unrelated trade or business under IRC section 513.

The facts and circumstances of each individual case must be considered in determining whether an activity is an unrelated trade or business. Actions to consider are setting up a Form 990-T filing requirement and/or completing a ROO or exam referral.

The sale of artwork may or may not preclude exemption under IRC section 501(c)(3). In reviewing the Form 1023 of any organization claiming the promotion of the arts, carefully examine all of the applicant’s activities, particularly commercial type activities, to ensure that they are conducted in an educational and charitable manner.

Additional information on promotion of the arts can be found at IRM 7.25.3.7.10. Also, a sample denial letter discussing private benefit and inurement is available in the NERD Drive under the Technical Issues \ Art Education folder.
Publishing Activities

Introduction

Publishing activities can be a means of attaining an exempt purpose or a commercial venture.

Many IRC section 501(c)(3) organizations engage in insubstantial publishing activities when they provide items such as newsletters, brochures, and other informational items about their organization. Other organizations are formed primarily to engage in substantial publishing and their activities are not easily distinguished from those of a commercial publishing enterprise.

The analysis employed in deciding whether publishing primarily furthers exempt purposes is a highly factual one, and the resolution of one case often provides little guidance for the next. The need for objective criteria in this area was addressed by the publication of Rev. Rul. 67-4, 1967-1 C.B. 121.

This lesson explains how to distinguish publishing activities that are “educational” and qualify as exempt under IRC section 501(c)(3) from those that are primarily commercial in nature.

Rev. Rul. 67-4 Criteria

To be described in IRC section 501(c)(3), a publishing organization must be operated exclusively for charitable purposes. These include religious or educational purposes since educational activities often include literary and scientific publishing.

In Rev. Rul. 67-4, the Service recognized four criteria indicating that publishing activities are directed to the attainment of purposes specified in IRC section 501(c)(3). These criteria are:

- Content of the publication must be educational
- Preparation of the materials must follow methods generally accepted as educational in character
- Distribution of the materials must be necessary or valuable in achieving the organization’s exempt purposes

Manner of distribution of the materials must be distinguishable from ordinary commercial publishing practices.
Publishing Activities, Continued

**Rev. Rul. 67-4 Criteria (continued)**

Under this standard, it is not sufficient that a particular publication be educational since books generally have this attribute to a greater or lesser degree.

Also, while the revenue ruling speaks only in terms of educational purposes, similar reasoning is applicable to religious publishing activities. However, religious publishing activities do not have to satisfy the second criterion, the methodology test.

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**Rev. Rul. 67-4 Criteria 1**

The first two of the four criteria relate to educational content and educational methodology. The term “educational” is defined in Treas. Reg. 1.501(c)(3)-1(d)(3) as relating to:

a. The instruction or training of the individual for the purpose of improving or developing his capabilities; or

b. The instruction of the public on subjects useful to the individual and beneficial to the community.

An organization may be educational even though it advocates a particular position or viewpoint if it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion.

An organization is not educational if its principal function is the mere presentation of unsupported opinion.

*Continued on next page*
Publishing Activities, Continued

Rev. Rul. 67-4
Criteria 2

The methodology test focuses on the techniques used by an organization in advocating a position on controversial subjects rather than on the position or viewpoint itself.

The techniques used will not be considered to be educational if they fail to provide a factual foundation for the viewpoint or position being advanced or fail to provide relevant facts that would materially aid a listener or reader in a learning process.

Note: Advocacy of controversial issues may be a higher-graded activity and should be discussed with your manager.

Rev. Rul. 67-4
Criteria 3

The third criterion is that the distribution of the publication be necessary to achieve the organization’s purpose. Analyze the facts and circumstances to determine if distribution is necessary and valuable to achieving the organization’s exempt purpose.

For example, it’s reasonable to conclude that publishing activities are necessary for an organization whose primary purpose is to promote literary excellence and to provide a forum for articles and writers unlikely to be published in profit-oriented magazines.

Instructor Notes

Discuss additional examples on how an exempt publishing activity can be distinguished from a commercial activity

Rev. Rul. 67-4
Criteria 4

Both religious and educational publishing organizations must meet the fourth requirement of Rev. Rul. 67-4; that is, their activities must be distinguishable from the activities of an ordinary commercial publishing operation.

Rev. Rul. 77-4, 1977-1 C.B. 141, provides an example of an ordinary commercial publishing operation.

Continued on next page
Publishing Activities, Continued

Rev. Rul. 67-4
Application

The organization described in Rev. Rul. 67-4 was formed to encourage basic research in specific types of physical and mental disorders, to improve educational procedures for teaching those afflicted with such disorders, and to disseminate educational information about such disorders by the publication of a journal containing current technical literature relating to these disorders.

The organization was found to qualify under IRC section 501(c)(3) because:

- Methods used in preparing and presenting the research information conformed to methods traditionally accepted as “educational” in character
- The organization provided a reference to literature on the research undertaken in the area, and enabled the afflicted to receive improved instruction and treatment
- Distribution of the abstracts was carried out essentially in a “charitable” manner, in the sense that there was a public benefit derived from the distribution
- Charges for the publication recovered only a portion of the costs
### Examples of Publishing Activities

#### Exempt Publishing Activities

Rev. Rul. 66-147, 1966-1 C.B. 137, holds that an organization that made surveys of scientific and medical literature, prepared abstracts, published them, and distributed them free of charge is exempt under IRC section 501(c)(3) as an educational organization.

Rev. Rul. 79-369, 1979-2 C.B. 226, holds that an organization created to develop and promote an appreciation of contemporary symphonic and chamber music by recording and selling, primarily to educational institutions, new works of unrecognized composers as well as neglected works of more established composers is exempt from tax under IRC section 501(c)(3).

#### Non-Exempt Publishing Activities

Rev. Rul. 60-351, 1960-2 C.B. 169, holds that a non-profit corporation that published a foreign language magazine on a subscription basis comparable to ordinary commercial publishing practices is engaged in a trade or business and is denied exemption under IRC section 501(c)(3).

#### Education v. Advocacy

As with any educational activity, substantial publishing activities should be developed for potential advocacy issues based on the facts and circumstances of the case. Rev. Proc. 86-43, 1986-2 C.B. 729, sets forth specific criteria to determine the circumstances under which advocacy of a particular viewpoint or position by an organization is considered educational within the meaning of IRC section 501(c)(3). Advocacy issues/topics should be checked against the current Case Assignment Guide and if necessary, reviewed with your manager for possible case upgrade/reassignment.

#### Additional References

Additional information can be found at IRM 7.25.3.7.11.1 and the 1988 CPE article, *IRC 501(c)(3) Organizations and Publishing Activities.*
Credit Counseling – Purely Educational (Financial Literacy, Instruction/Guidance on Housing, etc.)

Introduction
For decades, many organizations have provided valuable credit counseling and education that assist consumers in putting their personal finances in order.

Credit counseling organizations provide valuable services to the public by educating consumers about better money management techniques, promoting debt reduction strategies, and helping their clients avoid bankruptcy and its financial consequences.

Instructor Notes
Explain current issues with credit counseling.

Explain that if a case involving financial counseling or other credit counseling activities does not appear to have been screened by the credit counseling group, discuss the case with the manager. Describe how an agent would know if it was screened in the designated group.

Background
Over the last few years, the Service has seen an increasing number of “abusive” credit counseling organizations that appear motivated primarily by profit, and offer little or no counseling or education. In many cases, these organizations serve the private interests of related for-profit businesses, officers, and directors. Their activities typically include selling debt-management plans, credit repair services, bankruptcy certifications, debt repayment services, and debt consolidation services in exchange for a fee.

All credit counseling applications are examined and sorted by a designated group of specialists. The cases are separated into three groups: abusive, merit closures, and general unassigned inventory.

All cases identified as merit closures or abusive are worked within the designated group.

Cases identified for the general unassigned inventory consist of applicants whose primary purpose is something other than credit counseling, but include educational programs such as “financial literacy” among their planned activities.

This lesson discusses exemption issues often found in cases designated for the general unassigned inventory that have purely educational programs such as financial literacy, instruction and guidance on housing, home ownership, etc.
Financial Literacy

Keywords

Applications from organizations involved in purely educational credit counseling activities typically mention the following keywords:

- Financial literacy
- Financial management
- Budgeting classes
- Home ownership classes
- Money management
- Banking skills

Typical Programs

Cases in which financial literacy is an issue, but is not the organization’s primary activity, are typically routine applications.

These organizations offer purely educational classes, workshops, seminars, or counseling sessions aimed at educating individuals about banking, use of credit, and budgeting. Examples are churches offering free classes on creating a budget, youth development programs teaching kids how to open a bank account, or social service agencies showing their clients how to develop good spending habits.

These educational counseling programs are either provided to a charitable class of individuals or provided to the public at large for free or at a nominal charge.

Continued on next page
Rev. Rul. 69-441, 1969-2 C.B. 115, describes an organization qualifying as educational under IRC section 501(c)(3). The agency limits its services to low-income individuals and families with financial problems. Its board of directors is comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions. By aiding low-income individuals and families who have financial problems, and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization is relieving the poor and distressed.

The organization described in Rev. Rul. 69-441 limited its services to low-income individuals. However, such educational programs are not required to be limited to individuals in a charitable class to qualify for exemption under IRC section 501(c)(3). Public education itself, even if not limited to a charitable class, is a charitable purpose provided that the educational activities are carried out in an exempt manner.

Consider the following revenue rulings which involve other varieties of counseling organizations qualifying for exemption under IRC section 501(c)(3):

- Rev. Rul. 68-71, 1968-1 C.B. 249 – career planning education through free vocational counseling and publications sold at a nominal charge
Financial Literacy, Continued

Public Education (continued)

Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public. Even though they are not dealing directly with financial counseling, they have the same rationale for exemption as furthering charitable and/or educational purposes.

Rev. Rul. 67-138

In addition to instruction on personal finance, organizations may offer instruction and guidance on housing issues. This includes homebuyer education and home ownership classes.

Rev. Rul. 67-138, 1967-1 C.B. 129, describes an organization formed to assist low-income individuals and families in obtaining adequate housing. In addition to other charitable programs, the organization encourages “self-help” by conducting an educational training course on various aspects of home construction and home ownership.

Instructor Notes

Exhibit 1 is not attached to this lesson. Available in Training Library in Public Folders – CAG Training.

Case Issue Development Questions

Specialists have access to an existing list of general questions relating to financial literacy activities.

When developing the case, specialists should focus on:

- What the activity involves
- Who teaches the class
- Whether the organization will refer participants to other services
- Whether the organization is involved in any other credit counseling activities not stated in the application

Continued on next page
### Internet Research

Internet research is a valuable tool to develop any application, but even more crucial for those involved in these activities. Be sure to review the applicant’s website, as well as utilize search engines, such as *Google™*, to uncover any connections not revealed in the application.

### Instructor Notes

| Exhibit 2 is not attached to this lesson. Available in Training Library in Public Folders – CAG Training |

### Development Checklist

The specialist should start completing the *Financial Literacy Checklist* as a guide (Exhibit 12B-1).

### Instructor Notes

| Exhibit 3 is not attached to this lesson. Available in Training Library in Public Folders – CAG Training |

### Private Benefit

If the organization reveals that it is using volunteers from for-profit companies to present information, the specialist must develop the activity to ensure that the for-profit companies are not receiving a substantial benefit as a result of their involvement.

If the organization reveals that it is referring its clients to other organizations, the specialist must develop the issue to ensure that any organization receiving referrals does not receive an excess benefit as a result.

*Continued on next page*
Financial Literacy, Continued

Case Transfer  If subsequent taxpayer correspondence indicates that the applicant is involved in potentially abusive credit counseling activities which were not initially mentioned in the application (debt management plans, credit repair, debt consolidation, debt negotiation, etc.), the case may warrant transfer to the designated credit counseling group.

However, the specialist should first discuss the issue with their group manager.

Case Closure  Specialists must include the completed Financial Literacy Checklist in the case file as part of their closing work papers.
Education of Youth

General

Treas. Reg. 1.501(c)(3)-1(d)(2) holds that the education of youth may be either educational, as forming the character of youth, or charitable in the broader sense, in that the programs may prevent juvenile delinquency.

Programs providing recreation to youth under the age of eighteen may be educational because they:

- Teach youth a skill, a sport, a hobby, etc. and/or
- Form the character of youth, or
- Provide support (supervision, facilities, etc.) while the above 1 and 2 take place

Note that education of youth, although by recreational activities, further educational and charitable purposes.

Examples

Teaching a Sport

- Rev. Rul. 65-2, 1965-1 C.B. 227, holds that a foundation, which provided free instruction, equipment, and facilities to teach a particular sport to children, was organized and operated exclusively for educational purposes.

Supervised Drag Strip

- The court has ruled in Lions Associated Drag Strip v. United States, 13 A.F.T.R. 2d 973 (1963), 64-1 U.S.T.C. 9283, that the maintenance of a supervised drag strip for young people was an educational purpose.

Regulating a Sport

- Rev. Rul. 80-215, 1980-2 C.B. 124, holds that an otherwise qualifying organization that is formed to develop, promote, and regulate a sport for individuals under 18 years of age by organizing local and statewide competitions, promulgating rules, organizing officials, presenting seminars, distributing a newsletter, and otherwise encouraging growth of the sport qualifies for exemption under IRC section 501(c)(3).

Continued on next page
Examples (continued)

Promoting and Regulating a Sport for Amateurs

- Conversely, Rev. Rul. 70-4, 1970-1 C.B. 126, holds that an organization engaged in promoting and regulating a sport for amateurs is not exempt under IRC section 501(c)(3) but is exempt under IRC section 501(c)(4). Note: Participants in this case were not limited to individuals under the age of 18.
## Amateur Athletic Organizations and 501(j)

**Added to the Code**
The Tax Reform Act of 1976 amended IRC section 501(c)(3) to provide for exemption of organizations organized and operated exclusively to foster national or international amateur sports competition, provided they do not furnish athletic facilities or equipment. These organizations are known as amateur athletic organizations.

The Tax Reform Act was amended in 1983 by adding a new Code section IRC section 501(j) which provides generally that an amateur sports organization that otherwise satisfies the requirements of IRC section 501(c)(3) will qualify as exempt regardless of whether it provides athletic facilities or equipment and regardless of whether its membership is local or regional in nature. These organizations are known as “qualified amateur athletic organizations.”

**Qualification**
Amateur Athletic Organizations can qualify for exemption under IRC section 501(c)(3) as:

- Educational (Rev. Rul. 80-215, 67-291, 64-275)
- Charitable (as seen in Rev. Rul. 80-215 – preventing juvenile delinquency)
- Fostering national or international amateur sports competition

**Fostering National or International Competition**
There are two types of organizations that foster national or international sports competitions:

1. Amateur Athletic Organizations
   - Organized and operated exclusively to foster national or international sports competitions, and
   - Does not provide facilities or equipment
Amateur Athletic Organizations and 501(j), Continued

Fostering National or International Competition
(continued)

2. Qualified Amateur Athletic Organizations (GCM 39560)
   - Organized and operated exclusively to foster national or international sports competitions, and
   - Organized and operated primarily to conduct national or international amateur sports competitions, or support and develop athletes for national or international sports competitions.
   - May provide sports facilities and equipment
   - May have a local or regional membership
   - All of its members don’t have to be serious athletes

Instructor Notes
Explain professional athletic teams are a higher graded issue and should be discussed with the manager.

Age
In the case of amateur athletic organizations, age is not a factor. The major consideration is the amateur status of the athlete.

Factors to Consider
Factors to consider in processing applications for amateur athletic organizations include:

- See factors listed in the 1987 CPE article, *Amateur Athletic Organizations*
- What are the qualifications of the instructors and coaches
- Who is eligible to receive training
- Request a schedule of competitions
- Are sports facilities and equipment provided

Continued on next page
Factors to Consider (continued)

- Does the organization conduct national or international sports competitions
- Do the local or regional competitions conducted by the organization qualify the participants for national competitions
- Is the organization affiliated with or sanctioned by a national or international sports organization
Other Community Educational Activities

**Marriage Counseling, Workshops and Seminars**

Rev. Rul. 70-640, 1970-2 C.B. 117, holds that an organization providing marriage counseling services and conducting workshops and seminars on marital adjustment is engaged in education of the public.

**Exhibitions at a Fair**

Rev. Rul. 67-216, 1967-2 C.B. 180, holds that an organization that holds a fair for the exhibitions of livestock, poultry, and farm products is exempt under IRC section 501(c)(3).

**Radio Broadcasting**

Rev. Rul. 66-220, 1966-2 C.B. 209, holds a non-profit radio station broadcasting material of an educational nature without commercial sponsorship was exempt under IRC section 501(c)(3).

**Fostering Understanding and Tolerance**

Rev. Rul. 78-305, 1978-2 C.B. 172, holds that an organization formed to foster and understanding and tolerance of homosexuals and their problems qualifies for exemption.

**Genealogical Societies**

Rev. Ruls. 80-301 and 302, 1980-2 C.B. 180 and 192, distinguishes between when an activity benefits the general public and not private interests. This decision compares two genealogical societies one of which conducted activities directed to the general public, which is an acceptable educational purpose, and one which directed its activities to the members of one family that is not an acceptable educational purpose.

**Research in Physical and Mental Disorders**

An organization formed for the purpose of encouraging basic research in specific types of physical and mental disorders, to improve educational procedures for teaching those afflicted with such disorders, and to disseminate educational information about such disorders, by the publication of a journal containing current technical literature relating to these disorders qualifies for exemption under IRC section 501(c)(3) if they meet prescribed conditions. (Rev. Rul. 67-4, 1967-1 C.B. 121)

*Continued on next page*
Other Community Educational Activities, Continued

Sports Clinics, Workshops, Lessons and Seminars

In Rev. Rul. 77-365, 1977-2 C.B. 192, an organization that conducts clinics, workshops, lessons, and seminars at municipal parks and recreational areas to instruct individuals in a particular sport, qualified under IRC section 501(c)(3).

Education implies some form of systematic coaching which would encourage progress in mastering the particular sport. However, participation in athletic activities is not always an educational activity.

Rev. Rul. 67-109 1967-1 C.B. 136, concluded that a non-profit organization formed to operate a roller skating rink as a recreational facility for the benefit and use of all of the residents of a particular county in a county-owned building which it occupies rent-free in cooperation with the county government qualified under IRC section 501(c)(4) not 501(c)(3).

Films, Lectures and Publications

Rev. Rul. 66-255, 1966-2 C.B. 210, holds that an organization that educated the general public on painless childbirth through the use of films, lectures, and publications was an educational organization.

While reviewing an applicant’s activity description and related materials (publications, brochures, newsletters, etc.), you may discover that the organization intends to conduct legislative and political programs. What some organizations consider to be educating the public may in fact involve legislative or political activities.

Instructor Notes

Explain additional training on legislative and political activities will be discussed more in depth in Unit 1b. Also indicate that many of these activities are higher graded issues.

Continued on next page
Legislative and Political Activities

Examples of legislative and political activities include:

- *Action organizations
- Contributions to political campaign funds
- Extensive internet activity involving candidates or legislation
- Involvement in any type of public policy issues (capital punishment, racial integration, birth control methods, firearms control, etc.)
- Political campaign intervention
- Presentation of public forums or debates
- Propose, support or rate political candidates
- Providing assets, facilities or services for political campaign activities
- Publication of voter education guides
- Publishing a compilation of a candidate’s position or voting record
- Voter education
- Voter registration activities including get-out-the-vote drives

*Treas. Reg. 1.501(c)(3)-1(c)(3)(i) states that an organization is not operated exclusively for one or more exempt purposes if it is an “action” organization. Treas. Reg. 1.501(c)(3)-1(c)(3)(iii) an “action” organization as an organization that participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

Applications that involve legislative and political activities are processed by specialists that have completed specific training on these issues. If these types of activities are discovered during case processing the specialist should discuss the case with their group manager to determine appropriate action.

Instructor Notes

Administer and go over answers to Class Exercise 12B-1.
Summary

The term “educational” relates to the instruction of the public on subjects useful to the individual and beneficial to the community for the purposes of exemption under IRC section 501(c)(3). Activities that may be considered to be educational include promotion of the arts, publishing, credit counseling, financial literacy, the education of youth, and other community educational activities.

Promotion of the arts and literature has traditionally been recognized as an educational activity. Educational and commercial activities intersect in promotion of art and theater. Commercial transactions must be examined closely to ensure that they are conducted in an educational manner and serve public rather than private interests. In particular, the sale of art must be closely reviewed to ensure that the organization is not operating in a commercial manner and that there is no private benefit or inurement present which would preclude exemption.

Publishing activities can be a means of attaining an exempt purpose or a commercial venture. IRC section 501(c)(3) organizations may engage in insubstantial publishing activities such as newsletters, brochures, and other informational items about their organization. Other organizations are formed primarily to conduct substantial publishing activities that are not easily distinguished from those of a commercial publishing enterprise.

There are specific criteria set forth in Rev. Rul. 67-4 to determine whether an organization’s publishing activities are directed to the attainment of purposes specified in IRC section 501(c)(3). These criteria are:

- Content of the publication must be educational
- Preparation of the materials must follow methods generally accepted as educational in character
- Distribution of the materials must be necessary or valuable in achieving the organization’s exempt purposes
- Manner of distribution of the materials must be distinguishable from ordinary commercial publishing practices

Continued on next page
Credit counseling organizations provide valuable services to the public by educating consumers about better money management techniques, promoting debt reduction strategies, and helping their clients avoid bankruptcy and its financial consequences. Cases identified for the general unassigned inventory consist of applicants whose purely educational programs include such topics as financial literacy, instruction and guidance on housing, home ownership, etc. These educational counseling programs are generally provided to a charitable class of individuals or provided to the public at large for free or at a nominal charge.

The education of youth may be either educational, as forming the character of youth, or charitable in the broader sense, in that the programs may prevent juvenile delinquency. Programs providing recreation to youth under the age of eighteen may be educational because they teach youth a skill, a sport, a hobby, etc. and/or form the character of youth, or provide support (supervision, facilities, etc.) for such activities.

IRC section 501(j) provides for exemption of organizations organized and operated exclusively to foster national or international amateur sports competition. An amateur sports organization that otherwise satisfies the requirements of IRC section 501(c)(3) will qualify as exempt regardless of whether it provides athletic facilities or equipment and regardless of whether its membership is local or regional in nature. These organizations are known as “qualified amateur athletic organizations.” There are no age limitations for organizations which qualify under this designation.

Other examples of community educational activities include counseling activities, broadcasting material of an educational nature without commercial sponsorship, and educating the public on various topics through the use of films, lectures, and publications.
# Financial Literacy Screener Checklist

(Secondary Screeners Only)

<table>
<thead>
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<th>Organization Name</th>
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If the organization is involved in financial literacy activities that are not the primary activity, this checklist should be completed.

## Part A  General Issues

This section asks about general operational details and private benefit issues.

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IRS 01553
IRS 01553
Chapter 12
Lesson 12C

Schools and Scholarships

Instructor Preparation

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Chapter 12
Lesson C
Objectives

After completing this chapter you will be able to:

• Identify school criteria provided under IRC Section 170(b)(1)(A)(ii)

• Identify when an organization qualifies for prospective exemption as a school

• Determine whether organizations meet the school requirements set forth in Rev. Proc. 75-50
• Determine whether schools are required to annually file Form 990

• Identify when child care organizations qualify as schools

• Determine when vocational schools and student operated business conduct qualifying educational activities

• Identify when scholarship/grant programs qualify as charitable
Chapter 12
Lesson 12C
Schools and Scholarships

Overview

Introduction
This section will focus on organizations applying for exemption as "schools" as defined in IRC section 170(b)(1)(A)(ii). The discussion will include commonly seen private schools and schools that are less frequently seen such as those operated for the benefit of the blind or handicapped, qualifying child care organizations, and vocational schools. The lesson will also examine student operated businesses and other activities that qualify as educational because they are conducted to further education. Finally, the lesson will address scholarship and grant programs.

Objectives
At the end of this lesson you will be able to:

- Identify school criteria provided under IRC section 170(b)(1)(A)(ii)
- Identify when an organization qualifies for prospective exemption as a school
- Determine whether organizations meet the school requirements set forth in Rev Proc 75-50
- Determine whether schools are required to annually file Form 990
- Identify when child care organizations qualify as schools
- Determine when vocational schools and student operated businesses conduct qualifying educational activities
- Identify when scholarship/grant programs qualify as charitable

Continued on next page
Overview, Continued

This lesson contains the following topics:

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<tr>
<td>Exhibit 12C-2: Private School Determination Case Checksheet</td>
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</table>
Private Schools

| Instructor Notes | Explain that if students have a school that appears to be a home school, charter school or internet school, or is located in Louisiana or Mississippi, they should discuss the case with their manager. |

"Traditional School" Focus

This lesson focuses on "traditional" private schools requesting exemption under IRC section 501(c)(3) and classification as a school as defined in IRC section 170(b)(1)(A)(ii).

For purposes of this section, "traditional" will not include charter schools, home schools, and internet schools. Discussion of non-traditional schools is provided in subsequent training. Often, non-traditional activities are not identified in the initial screening of the application, but are discovered during case development through additional information requests or review of the organization's website.

If non-traditional activities, schools located in Mississippi or Louisiana, or related party transactions are identified during case development, the specialist should discuss the case with their group manager to determine appropriate action.
## IRC Section 170(b)(1)(A)(ii) Required Elements

### Defined

Education is defined in the Treasury Regulations as “the instruction or training of the individual for the purpose of improving or developing his/her capabilities.” Treas. Reg. 1.501(c)(3)-1(d)(3)(i)(a) and IRM 7.25.3.7.

Educational organizations described in IRC section 170(b)(1)(A)(ii) and Treas. Reg. 1.170A-9(b)(1), such as primary schools and universities, are excluded from private foundation status under IRC section 509(a)(1).

IRC section 170(b)(1)(A)(ii) organizations are commonly known as "schools."

### Types

Instruction of individuals occurs in:

- Primary and secondary schools (private and public)
- Colleges
- Professional or trade schools

(See IRM 7.20.4.2 – Private Schools)

### Public Schools

A public school, **if separately incorporated or organized**, may qualify under IRC sections 501(c)(3) and 170(b)(1)(A)(ii) even though it is an instrumentality of a governmental unit. However, an instrumentality is a complex, higher graded issue and should be discussed with your manager for possible case upgrade or reassignment.

If a public school is not separately organized, discuss the case with your manager for further actions to be taken.

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*Continued on next page*
An organization requesting foundation classification as a school under IRC section 170(b)(1)(A)(ii) must meet the following criteria (see Schedule B, Form 1023):

- Present formal instruction as its “primary” function
- Present a regularly scheduled curriculum
- Maintain a regular faculty of qualified teachers
- Have a regularly enrolled student body
- Have facilities where its educational activities are regularly carried on
**Formal Instruction – Primary Function**

**Instructor Notes**

Explain “primary” is generally considered 51% or more.

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**“Primary” Function is Formal Instruction**

An organization is not described in IRC section 170(b)(1)(A)(ii) unless its primary function is the presentation of formal instruction. Any non-educational activities must be merely incidental to the educational activities. Treas. Reg. 1.170A-9(b)(1).

An organization whose activities are educational in the broad sense, and which also maintains an educational institution in the nature of a school as a secondary or incidental activity, does not qualify under IRC section 170(b)(1)(A)(ii).

All facts and circumstances must be considered to determine an organization’s “primary” function, such as:

- percentage of expenditures allocable to the various functions
- percentage of time of directors, officers, and employees allocable to the various functions
- the way in which the organization describes itself in dealings with the public

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**“Primary” Function Examples**

An organization that presented formal instruction but whose primary activity was maintaining and operating a museum was held not an IRC section 170(b)(1)(A)(ii) organization. (Rev. Rul. 76-167, 1976-1 C.B. 329)

Rev. Rul. 73-434, 1973-2 C.B. 71, granted school foundation within the meaning of IRC section 170(b)(1)(A)(ii) to an organization exempt from tax under IRC section 501(c)(3) that has full-time instructors who regularly conduct a 26-day survival course, mostly out-of-doors, to teach young people how to survive in a natural environment. The organization qualified as a school since (1) its primary function is the presentation of formal instruction, (2) its courses are interrelated and are given in a regular and continuous manner, thereby constituting a regular curriculum, (3) it normally maintains a regular faculty, and (4) it has a regularly enrolled body of students in attendance at a place where its educational activities are carried on.

(See IRM 7.26.2.3.2.3 for more information regarding primary function)
IRC section 170(b)(1)(A)(ii) requires that an educational organization "normally" maintain a regular curriculum. In other words, a school must:

- Have a curriculum (i.e., a course or courses of study) – An organization need not present courses in traditional academic subjects to satisfy the curriculum requirement. A curriculum may be partly or wholly religious in nature.

- Which must be offered on a recurrent basis – An organization that merely offers a series of unrelated lectures or conferences will not meet the regular curriculum requirement.

The "normally" requirement first appeared in the predecessor language of IRC section 170(b)(1)(A)(ii) during World War II for the benefit of schools whose operations were suspended or curtailed during the war due to lack of faculty or students. (See S. Rep. No. 627, 78th Cong., 1st Sess. 46 (1943))

Where a new organization is taking reasonable steps that lead to operation as an IRC section 170(b)(1)(A)(ii) organization, it may be treated as “normally” meeting the requirements of IRC section 170(b)(1)(A)(ii).

The curriculum described in Rev. Rul. 78-82, 1978-1 C.B. 70, did not qualify for IRC section 170(b)(1)(A)(ii) classification because the courses concerned a general area, and they were not organized into an interrelated curriculum so as to constitute formal instruction or offered on a regular basis.

Rev. Rul. 79-130, 1979-1 C.B. 332, provided that an IRC section 501(c)(3) organization had a qualifying curriculum because it conducted regularly scheduled eight week courses for registered students in various aspects of Yoga. Each class session was repetitive, covering the same basic instruction as the previous class session.
Curriculum, Continued

Curriculum Examples (continued)

Rev. Rul. 64-287, 1964-2 C.B. 403, provided that an IRC section 501(c)(3) religious organization had a qualifying curriculum because the organization offered a number of courses in philosophy and religion to upper classmen at a university for which the university allowed credits toward graduation. The classes met at regularly scheduled hours each week during the school term and corresponded in some respects to courses offered by the university.

(See IRM 7.26.2.3.4.1 and IRM 7.26.2.3.6 for more information regarding regular curriculum)
<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain what is meant by a “qualified.”</th>
</tr>
</thead>
</table>

Maintain Regular Faculty

IRC section 170(b)(1)(A)(ii) requires that an educational organization normally maintain a regular faculty. Generally, this requirement is met if:

- Qualified teachers instruct the students and
- The same teachers do so on a recurrent basis

Faculty Examples

Rev. Rul. 74-46, 1974-1 C.B. 304, found that an organization recognized as exempt under IRC section 501(c)(3) does not normally maintain a regular faculty where the organization engages solely in conducting an activity known as ‘involvement drama’ or ‘participation theater.’ The organization performs in public and private schools, in institutions for the handicapped, and in children's wards of hospitals. The principal actors (or leaders) are usually college-age students specializing in involvement drama.

Rev. Rul. 64-128, 1964-1 C.B. 191, found that an organization recognized as exempt under IRC section 501(c)(3) and incorporated to engage in research, conduct lectures and hold conferences does not normally maintain a regular faculty, since leading authorities on the selected subject are appointed to write papers presenting background material.
<table>
<thead>
<tr>
<th>Regularly Enrolled Student Body</th>
<th>The student body described in Rev. Rul. 72-101, 1972-1 C.B. 144, qualified under IRC section 170(b)(1)(A)(ii) as &quot;regularly enrolled.&quot; The students were selected by the trustees from individuals applying to the organization for enrollment in its training program to acquire skills in a particular industry. The student body attends the school five full days a week.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rev. Rul. 69-492, 1969-2 C.B. 36, qualified the student body enrolled in a school conducting training in theological studies. Classes are taught on a graduate level by college and seminary professors and the school is chartered by the State and empowered to grant Master of Arts degrees. The school has a regularly enrolled body of students and it meets for approximately eight weeks each summer, using the campus facilities of another school. It does not hold classes during the remainder of the year. The degree is awarded to qualified students who successfully pass a comprehensive examination based on three summers of full-time resident study.</td>
</tr>
<tr>
<td></td>
<td>The student body described in Rev. Rul. 64-293, 1964-2 C.B. 404, did not qualify under IRC section 170(b)(1)(A)(ii) as &quot;regularly enrolled.&quot; The organization conducted a &quot;directors' school&quot; twice a year for program directors of a religious organization. Although the organization's activities were educational in nature and having some characteristics of a school, it did not normally maintain a regular faculty and curriculum, nor does it normally have a regularly enrolled body of pupils or students in attendance at the place where its educational activities are carried on.</td>
</tr>
</tbody>
</table>

(See Rev. Rul. 64-128, 1964-1 C.B. 191, and 74-46, 1974-1 C.B. 304)

(See IRM 7.26.2.3.6 for more information regarding regularly enrolled student body)
Facility

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that facilities are not necessarily brick and mortar buildings</th>
</tr>
</thead>
</table>

Facility Where Educational Activities Are Regularly Carried On

An IRC section 170(b)(1)(A)(ii) organization's students must attend at the place where its educational activities are regularly carried on. The "place" requirement does not mean that the educational activities must be conducted in a traditional classroom style setting. Also, the organization need not own its own facilities but may use those of another school.

Facility Examples

The "facilities" described in Rev. Rul. 75-215, 1975-1 C.B. 335, and Rev. Rul. 73-434, 1973-2 C.B. 71, met the facility requirements of IRC section 170(b)(1)(A)(ii). In both cases, the organizations were conducting their educational activities out of doors rather than in a traditional classroom setting.

The organization described in Rev. Rul. 75-492, 1975-2 C.B. 80, did not meet the facility requirement of IRC section 170(b)(1)(A)(ii). The organization did not have a regular place where educational activities were carried on because instruction was provided through correspondence.

(See IRM 7.26.2.3.7 for more information regarding the facility requirement)
Can an organization qualify for prospective exemption under IRC section 501(c)(3) and be classified as a school as defined in IRC section 170(b)(1)(A)(ii) when they have not yet begun operations?

Yes. We issue exemption determinations under IRC section 501(c)(3) to organizations that have not yet begun activities provided the applicant can provide a detailed description of their proposed activities including sufficient financial information. Rev. Proc. 2009-9 section 4.03 states, "Exempt status may be recognized in advance of the organization’s operations if the proposed activities are described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements for exemption pursuant to the section of the Internal Revenue Code under which exemption is claimed."

Items to consider when developing a prospective school application. Has the applicant:

- Described its purpose and educational programs and activities
- Developed a curriculum
- Hired a faculty or staff
- Established a facility
- Developed an admission policy

If the applicant has established that it will conduct educational activities but has not taken steps to develop the items listed above, the organization may be given a ruling under IRC sections 509(a)(1) and 170(b)(1)(A)(vi) or 509(a)(2) as an organization that expects to receive public support through contributions and/or payments related to its exempt purposes and may request reclassification in the future.
<table>
<thead>
<tr>
<th><strong>Existing Facility Required?</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>In situations where the organization will maintain a traditional bricks and mortar type facility, does the facility have to be constructed for the organization to qualify as a school as defined in IRC section 170(b)(1)(A)(ii)?</td>
</tr>
<tr>
<td>No.  A facility does not have to be constructed for the organization to qualify as a school as defined in IRC section 170(b)(1)(A)(ii). Generally, we will classify an organization as a school before it is operational if it has definite plans to build/buy and operate as a school. We would be reluctant to classify an organization as a school where their plans are vague or general, meaning they cannot provide us with details of their curriculum, staff, student body, facility, etc.</td>
</tr>
</tbody>
</table>
All educational organizations classified under IRC section 170(b)(1)(A)(ii) must have racially nondiscriminatory policies as to students to qualify under IRC section 501(c)(3). Rev. Proc. 75-50 sets forth guidelines and recordkeeping requirements for determining whether private schools that are applying for recognition of exemption from Federal income tax under IRC section 501(c)(3) have racially nondiscriminatory policies as to students (see Exhibit 12C-1).

A seminary or other “purely religious” school which primarily teaches religious subjects for the purpose of training students for the ministry is not subject to Rev. Proc. 75-50 nondiscriminatory requirements because it is considered to be a religious organization, not an educational organization.

Rev. Proc. 75-50 does apply to schools operated by churches or a convention or association of churches that have secular school operations, whether separately incorporated or operated as part of the organization’s overall operations. A separately incorporated secular school will be denied exemption for failure to accept any children from certain racial or ethnic groups.

Rev. Proc. 75-50 also applies to parochial schools. Parochial schools are not barred from accepting students based on membership in the denomination provided that the church itself does not restrict membership to a particular racial or ethnic group.

Continued on next page
School activities that would otherwise qualify for classification under IRC section 170(b)(1)(A)(ii) but are not the primary activity of an organization must still meet the requirements of Rev. Proc. 75-50, regardless of the foundation classification of the organization.
Revenue Procedure 75-50

| Instructor Notes | Explain many of the requirements are on Schedule B of the 1023. Have students look at Schedule B (hard copy or electronic). |

| Rev. Proc. 75-50 Requirements | In order to receive and maintain exempt status as an educational organization under IRC section 170(b)(1)(A)(ii), the organization must demonstrate it meets all guidelines of Rev. Proc. 75-50. The organization must establish a nondiscriminatory policy on admissions by: |
| | • Showing affirmatively it has adopted a nondiscriminatory policy |
| | • Showing it actually is operating in a nondiscriminatory way in the admission of students, and |
| | • Making its nondiscriminatory policy known to all segments of the community served by the school |
| Note: | The Service considers discrimination on the basis of race to include discrimination on the basis of color and national or ethnic origin. |

| Instructor Notes | Emphasize that only missing information (e.g. not on Schedule B) needs to be requested in an additional information request. Exhibit 12C-1 |

Continued on next page
Revenue Procedure 75-50, Continued

IRM 7.20.4.2.1 - Processing Private School Cases provides a list of items that a specialist must secure from an organization applying for exemption under IRC section 501(c)(3) as a school as defined in IRC section 170(b)(1)(A)(ii). Listed below are the guidelines provided in Rev. Proc. 75-50 that relate to the items discussed in IRM 7.20.4.2.1, followed by the information the organization must submit to demonstrate that it meets each requirement (see Exhibit 12C-2 Private School Determination Case Checksheet).

In many cases, much of this information is provided within the Form 1023 application on Schedule B and related attachments.

Caution: Specialists must carefully review the Form 1023 and all additional documents submitted to ensure that only missing information is requested from the applicant.

| Instructor Notes | Emphasize only statement that must be signed by more than one board member. |

Section 4.01

.01 Organizational requirements - A school must include a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy as to students and therefore does not discriminate against applicants and students on the basis of race, color, and national or ethnic origin.

The organization must submit a copy of their charter, bylaws or other governing instruments that includes the statement or a resolution signed and dated by the members of its governing board, which provides that the organization has a racially nondiscriminatory policy toward students.

Note: This is the only statement that must be signed by more than one board member of the organization.

Continued on next page
Section 4.02 02  Statement of Policy - Every school must include a statement of its racially nondiscriminatory policy as to students in all its brochures and catalogues dealing with student admissions, programs, and scholarships. A statement substantially similar to the Notice described in section 4.03 of Rev. Proc. 75-50 will be acceptable for this purpose. Further, every school must include a reference to its racially nondiscriminatory policy in other written advertising that it uses as a means of informing prospective students of its programs. The following reference will be acceptable:

"The M school admits students of any race, color, and national or ethnic origin."

The organization must submit copies of all brochures, application forms, advertisements and catalogues dealing with its student admissions, programs and scholarships, as well as representative copies of all written advertising that contains a statement of the organization's racially nondiscriminatory policy. If present literature does not contain a notice of the organization's racially nondiscriminatory policy, the organization must submit a statement signed by one of the principal officers that future literature will contain the required statement.

**Instructor Notes**

Discuss sections of the paper that would or would not be acceptable for publication of policy. Explain when the specialist should require that the notice be republished due to errors and when a signed statement to correct future publications would be appropriate.
Revenue Procedure 75-50, Continued

Section 4.03
Method 1

.03 Publicity - The school must make its racially nondiscriminatory policy known to all segments of the general community served by the school.

The school must use one of the following two methods to satisfy this requirement:

1. The school may publish a notice of its racially nondiscriminatory policy in a newspaper of general circulation that serves all racial segments of the community. This publication must be repeated at least once annually during the period of the school’s solicitation for students or, in the absence of a solicitation program, during the school’s registration period. Where more than one community is served by a school, the school may publish its notice in those newspapers that are reasonably likely to be read by all racial segments of the communities that it serves. The notice must appear in a section of the newspaper likely to be read by prospective students and their families and it must occupy at least three column inches. It must be captioned in at least 12 point bold face type as a notice of nondiscriminatory policy as to students, and its text must be printed in at least 8 point type.

The following notice will be acceptable:

**NOTICE OF NONDISCRIMINATORY POLICY AS TO STUDENTS**

*The M school admits students of any race, color, national and ethnic origin to all the rights, privileges, programs, and activities generally accorded or made available to students at the school. It does not discriminate on the basis of race, color, national and ethnic origin in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.*

Note: The notice must appear in a section of the newspaper likely to be read by prospective students and their families. Therefore, a notice published in the legal notices section or classified advertisements is generally not acceptable.

The organization must submit the entire page of the newspaper in which the notice appears. A reproduced copy of the notice is not acceptable.

*Continued on next page*
Revenue Procedure 75-50, Continued

Section 4.03

Method 2

2. The school may use the broadcast media to publicize its racially nondiscriminatory policy if this use makes such nondiscriminatory policy known to all segments of the general community the school serves.

The organization must provide documentation that the means by which this policy was communicated to all segments of the general community was reasonably expected to be effective. In this case, appropriate documentation would include copies of the tapes or script used and records showing that there was an adequate number of announcements, that they were made during hours when the announcements were likely to be communicated to all segments of the general community, that they were of sufficient duration to convey the message clearly, and that they were broadcast on radio or television stations likely to be listened to by substantial numbers of members of all racial segments of the general community.

Announcements must be made during the period of the school's solicitation for students or, in the absence of a solicitation program, during the school's registration period. Communication of a racially nondiscriminatory policy as to students by a school to leaders of racial groups as the sole means of publicity generally will not be considered effective to make the policy known to all segments of the community.

Section 4.03

Exceptions

The following are exceptions to the Publicity requirement discussed above:

- If for the preceding three years the enrollment of a parochial or other church-related school consists of students at least 75 percent of whom are members of the sponsoring religious denomination or unit.

- If a school customarily draws a substantial percentage of its students nationwide or worldwide or from a large geographic section or sections of the United States and follows a racially nondiscriminatory policy as to students.

- If a school customarily draws its students from local communities and follows a racially nondiscriminatory policy as to students.

(See section 4.03(2) of Rev. Proc. 75-50 for details regarding the above exceptions and the information that must be submitted to satisfy the publicity requirement)
Revenue Procedure 75-50, Continued

Section 4.03 Exceptions (continued)

(See section 4.03(2) of Rev. Proc. 75-50 for details regarding the above exceptions and the information that must be submitted to satisfy the publicity requirement).

The Service encourages schools to satisfy the publicity requirement by the methods described in 1 and 2 above, regardless of whether a school considers itself to meet one of the exceptions, because it believes these methods to be the most effective to make known a school's racially nondiscriminatory policy.

On audit, a school must be prepared to demonstrate that the failure to publish its racially nondiscriminatory policy was justified because it met one of the exceptions listed above. Further, a school must be prepared to demonstrate that it has publicly disavowed or repudiated any statements purported to have been made on its behalf (after November 6, 1975) that are contrary to its publicity of a racially nondiscriminatory policy as to students, to the extent that the school or its principal official were aware of such statements.

Instructor Notes

| Instructor Notes | Emphasize organization must submit numbers not percentages. |

Continued on next page
Revenue Procedure 75-50, Continued

Section 5.01(1) 01 Information required to be submitted - Every school filing an application for recognition of a tax exempt status must supply the Service with the following information:

1) Racial composition, as of the current academic year and projected so far as may be feasible for the subsequent academic year, of:
   a) Student body, and
   b) Faculty and administrative staff.

The organization must submit the numerical schedules discussed above. Actual numbers are required rather than percentages for each racial/ethnic class.

If the organization is not yet operational, the organization must estimate based on the best information available (such as the racial composition of the community served).

Section 5.01(2) 2. Amount of scholarship and loan funds, if any, awarded to students enrolled and racial composition of students who have received such awards.

As a general rule, all scholarship or other comparable benefits procurable for use at any given school must be offered on a racially nondiscriminatory basis. Their availability on this basis must be known throughout the general community being served by the school and should be referred to in the publicity required by this section in order for that school to be considered racially nondiscriminatory as to students. Consistent with section 3.02 of Rev. Proc 75-50, scholarships and loans that are made pursuant to financial assistance programs favoring members of one or more racial minority group that are designed to promote a school's racially nondiscriminatory policy will not adversely affect the school's exempt status. Financial assistance programs favoring members of one or more racial group that do not significantly detract from the school's racially nondiscriminatory policy similarly will not adversely affect the school's exempt status.

Organizations must submit the number and amount of loans and scholarships awarded to students enrolled by racial/ethnic categories.

Continued on next page
Revenue Procedure 75-50, Continued

Section 5.01(3)  3. A listing of incorporators, founders, board members, and donors of land or buildings, whether individuals or organizations.

The organization must submit a list of the incorporators, founders, board members, and donors of land or buildings.

Section 5.01(4)  A statement whether any of the organizations described in subsection .01-3 of this section have at the time the application is filed an objective of maintaining segregated public or private school education and, if so, a statement whether any of the individuals described in subsection .01-3 of this section are officers or active members of such organizations at the time the application is filed.

The organization must submit a statement as to whether any of its incorporators, founders, board members, and donors of land or buildings has an objective to maintain segregated public or private school education.

Section 7.01 Record Keeping Requirements  .01 Specific records - Except as provided in section 7.03, each exempt private school must maintain for a minimum period of three years, beginning with the year after the year of compilation or acquisition, the following records for the use of the Service on proper request:

1. Records indicating the racial composition of the student body, faculty, and administrative staff for each academic year.

2. Records sufficient to document that scholarship and other financial assistance is awarded on a racially nondiscriminatory basis.

3. Copies of all brochures, catalogues, and advertising dealing with student admissions, programs, and scholarships. Schools advertising nationally or in a large geographic segment(s) of the United States need only maintain a record sufficient to indicate when and in what publications their advertisements were placed.

4. Copies of all materials used by or on behalf of the school to solicit contributions.

Continued on next page
Section 7.02 Limitation

1. For purposes of section 7.01, the racial composition of the student body, faculty, and administrative staff may be an estimate based on the best information readily available to the school, without requiring student applicants, students, faculty, or administrative staff to submit information to the school that the school otherwise does not require. For each academic year, however, a record of the method by which racial composition is determined must be maintained. A school may not discontinue maintaining a system of records that reflects racial composition of students, faculty, and administrative staff used on November 6, 1975, unless it substitutes a different system that compiles substantially the same information, without the advance approval of the Internal Revenue Service.

2. The Service does not require that a school release personally identifiable records or personal information contained therein except in accordance with the requirements of the "Family Educational Rights and Privacy Act of 1974," 20 U.S.C. S1232g (1974). Similarly, the Service does not require a school to keep records the maintenance of which is prohibited under state or federal law.

Section 7.03 Record Keeping Requirements - Exceptions

03 Exceptions - The records described in section 7.01 need not be independently maintained for Internal Revenue Service use if:

1. Substantially the same information that each of these records would provide has been included in a report or reports filed in accordance with law with an agency or agencies of Federal, state, or local government, and this information is current within one year, and

2. The school maintains copies of these reports from which this information is readily obtainable. Records described in section 7.01 providing information not included in reports filed with an agency or agencies must be maintained by the school for Service use.

Continued on next page
Revenue Procedure 75-50, Continued

Section 7.04
Record Keeping Requirements - Exceptions

.04 Failure to maintain records - Failure to maintain or to produce upon the proper request the required records and information will create a presumption that the organization has failed to comply with these guidelines.

The organization must submit a statement that the organization will maintain records according to the provisions of Rev. Proc. 75-50, Section 7, in order to support the racially nondiscriminatory policy of the private school.
Application of Revenue Procedure 75-50

Rev. Rul. 71-447, 1971-2 C.B. 230, determined that a school not having a racially nondiscriminatory policy as to students is not ‘charitable’ within the common law concepts reflected in IRC sections 170 and 501(c)(3) and in other relevant Federal statutes and accordingly does not qualify as an organization exempt from Federal income tax.

Example 1

Prince Edward School Foundation v. Commissioner

The Service’s position of denial of exemption due to discrimination was upheld in the case of Prince Edward School Foundation v. Commissioner, 478 F. Supp. 107 (D.D.C. 1979) for these reasons:

• The School failed its burden of proof to show that black students were admitted on the same basis as white students.
• The inference drawn from the facts was that the School had a discriminatory policy for admitting students.
• The School was created to bypass a State desegregation order.
• The School had previously conceded that it practiced a racially discriminatory policy of exclusiveness.
• The School was previously enjoined from discriminatory practices, but provided no evidence that such practices had been modified.

Example 2

Bob Jones University

In the cases of Bob Jones University v. U.S. and Goldsboro Christian Schools, Inc. v. U.S., 461 U.S. 574 (1983), the U. S. Supreme Court upheld the revocation of exempt status for these reasons:

• The policies of Bob Jones University forbade interracial dating by its students.
• The Court held that discrimination based on religious beliefs barred the granting of tax exempt status under IRC section 501(c)(3).
• The act of discrimination was against public policy and did not meet the standards of charity.

(See IRM 7.25.3.7.2.1 - Significant Cases, for more information)
Form 990 Filing Requirement

Filing Requirement

Private schools exempt under IRC sections 501(c)(3) and 170(b)(1)(A)(ii) are required to file an annual return on Form 990 unless they meet one of the exceptions described under IRC section 6033(a)(3).

School Controlled by or Affiliated with a Church

Private schools (below college) that are affiliated with a church or a convention or association of churches or operated by a religious order are not required to file Form 990 (see Treas. Reg. 1.6033-2(g)(1)(vii)).

Treas. Reg. 1.6033-2(h)(2) defines "affiliation" as:

(i) The organization is covered by a group exemption letter issued under applicable administrative procedures, (such as Rev. Proc. 80-27 (1980-1 C.B. 677); See § 601.601(a)(2)(ii)(b)), to a church or a convention or association of churches;

(ii) The organization is operated, supervised, or controlled by or in connection with (as defined in § 1.509(a)-4) a church or a convention or association of churches; or

(iii) Relevant facts and circumstances show that it is so affiliated.

Relevant Facts and Circumstances

Treas. Reg. 1.6033-2(h)(3) states, "for purposes of paragraph (h)(2)(iii) of this section, relevant facts and circumstances that indicate an organization is affiliated with a church or a convention or association of churches include the following factors. However, the absence of one or more of the following factors does not necessarily preclude classification of an organization as being affiliated with a church or a convention or association of churches--

(i) The organization's enabling instrument (corporate charter, trust instrument, articles of association, constitution or similar document) or by-laws affirm that the organization shares common religious doctrines, principles, disciplines, or practices with a church or a convention or association of churches;

(ii) A church or a convention or association of churches has the authority to appoint or remove, or to control the appointment or removal of, at least one of the organization's officers or directors;

Continued on next page
Relevant Facts and Circumstances, (continued)

(iii) The corporate name of the organization indicates an institutional relationship with a church or a convention or association of churches;

(iv) The organization reports at least annually on its financial and general operations to a church or a convention or association of churches;

(v) An institutional relationship between the organization and a church or a convention or association of churches is affirmed by the church, or convention or association of churches, or a designee thereof; and

(vi) In the event of dissolution, the organization's assets are required to be distributed to a church or a convention or association of churches, or to an affiliate thereof within the meaning of this paragraph (h).”

Other factors to consider when determining whether a private school is "affiliated" with a church:

- Does either of the organizing documents specify that the church has any authority over the finances or operation of the school?

- Do the documents specify that one or more Board members must be selected by the church Board?
### Instructor Notes

Exhibit 12C-1

#### Private School Check sheet

Case files for recognition of exemption for private schools must include a completed Private School Determination Case Checksheet. Should the organization fail a sufficient number of categories on the Private School Determination Case Check sheet, EO Technical should be contacted.

#### Form 5578 Addendum

Agents closing cases involving private schools operated by churches are to add an addendum to Letter 947 stating that the organization is responsible for the annual certification attesting to adherence to the provisions of Rev. Proc. 75-50. Sample provided below:

"Section 4.06 of Revenue Procedure 75-50 requires that private schools provide to the Service annual certification that they are complying with Revenue Procedure 75-50. This is normally done on Form 990, Schedule A. However, since you are exempt from filing Form 990, you must complete Form 5578 annually to certify that you are complying with Revenue Procedure 75-50."

#### Mandatory Review

Private schools located in Mississippi and Louisiana, including "charter schools" and "home schools," are subject to mandatory review. Also subject to mandatory review are schools that were previously denied, successors to for-profit organizations, those engaging services from a management services organization, and those providing management services to one or more charter schools. See IRM 7.20.5.4 for the full list of cases subject to review. During the closing process, use Form 3198-A for those private school cases subject to mandatory review. Please note that the list of cases subject to review changes from time to time.

#### Private School Supplemental Reference Material

- 1980 CPE Article
- 1981 CPE Article
- 1987 CPE Article
- 2000 CPE Article
Schools for the Blind or Handicapped

"Charitable" Includes Relief of the Poor and Distressed

IRC section 501(c)(3) provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable or educational purposes.

Treas. Reg. 1.501(c)(3)-1(d)(2) defines the term "charitable" as used in IRC section 501(c)(3) as including the relief of the poor and distressed or of the underprivileged and the advancement of education.

An organization whose primary purpose is to relieve the major forms of distress to which the physically handicapped are susceptible is operated exclusively for charitable purposes.

Charitable v. 170(b)(1)(A)(ii) Educational Organization

That a nonprofit organization's primary purpose is to relieve the major forms of distress to which the physically handicapped are susceptible and conducts activities that include educational instruction do not, alone, determine the qualification for exemption as an educational organization set forth in IRC section 170(b)(1)(A)(ii).

Subject to 170(b)(1)(A)(ii) and Rev. Proc. 75-50

In order for such an organization to qualify as a "school," it must meet the description of an educational organization set forth in IRC section 170(b)(1)(A)(ii) with respect to faculty, curriculum, and a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. The organization must also satisfy the requirements of Rev. Proc. 75-50.

Continued on next page
Example of Charitable v. 170(b)(1)(A)(ii) Educational Organization

IRM 7.26.2.3.2.3 provides the following examples of "charitable" organizations that may or may not qualify as educational organizations described in IRC section 170(b)(1)(A)(ii).

- Rev. Rul. 62-6, 1962-1 C.B. 198, made a distinction between a school for mentally handicapped children and an organization that was primarily a residential facility for such children (who were students at the former), holding that the former but not the latter was a nonprofit educational organization for excise tax purposes.

- Rev. Rul. 79-403, 1979-2 C.B. 363, held that an organization that was equivalent to a boarding school for emotionally disturbed children was an IRC section 170(b)(1)(A)(ii) organization.

- Rev. Rul. 80-20, 1980-1 C.B. 231, found that an organization that provided classroom and on-the-job vocational training, employment, and other social services to handicapped individuals in a sheltered workshop and retail store was not an IRC section 170(b)(1)(A)(ii) organization, as its primary function was not the presentation of formal instruction, although the classroom training program was a school activity for excise tax purposes.

- Rev. Rul. 75-416, 1975-2 C.B. 417, where an organization that primarily provided social services to the blind and also conducted a vocational and rehabilitation training program for the blind was not an IRC section 170(b)(1)(A)(ii) organization, although the training program was a school activity for excise tax purposes.

(See also IRM 7.26.2.3.4.2(4))

Emerging Issues

An increasing number of applications have been received from very small schools organized to serve specific populations (such as autistic children). The schools are often founded by parents of the children and should be thoroughly developed for potential private benefit and inurement issues.
Child Care Organizations

Prior to 1984

Prior to July 18, 1984, the Service held that child care organizations seeking exemption under IRC section 501(c)(3) had to be organized and operated exclusively for a charitable or educational purpose.

501(k)

The Deficit Reduction Act of 1984 added IRC section 501(k) which provides for exemption of child care organizations as educational under IRC section 501(c)(3) if:

- Substantially all of the care provided by the organization is for the purpose of enabling individuals to be gainfully employed, and
- The services provided by the organization are available to the general public.

Note: Child care organizations which qualified for exemption as a charitable or educational organization under the precedents in existence prior to July 18, 1984, continue to qualify for exemption without consideration of IRC section 501(k).

Instructor Notes

Have student look at page 6 of 1023, #9. Explain many 501(k) requirements are listed in the 1023, page 6. If organization provides answers to these questions, it is not necessary to request the information in a letter. Pattern paragraphs should generally be edited to only request new information.

Explain services must be available to the general public.

“Gainfully Employed Individuals”

The term “enabling individuals to be gainfully employed” as used in IRC section 501(k) includes the following persons:

- Any employee
- Any self-employed person
- Any enrolled student or vocational school trainee
- Any individual actively seeking employment

Continued on next page
Child Care Organizations, Continued

“Substantially All” Defined
The term “substantially all” means 85% of the services of the organization must be provided to the children of the individuals named above.

“Available to the General Public” Defined
“Available to the general public” means the services must be made available to the general public within a set geographic boundary.

Note: Providing the services to a single employer would not be acceptable under the provisions of IRC section 501(k) but such services provided could qualify for exemption under other provisions of the Code.

Instructor Notes
Explain that some child-care organizations are converted from for-profit organizations. If it appears to have previously operated as a for-profit, discuss case with the manager for possible upgrade/reassignment.

Other Factors to Consider
The following factors should be considered:

- A child care organization classified as an educational organization by virtue of IRC section 501(k) is not a school as defined in IRC section 170(b)(1)(A)(ii).
- Because it is not classified a school, the provisions in Rev. Proc. 75-50 do not apply to a child care organization.
- A child care organization that has an admission policy which discriminates on the basis of color or ethnic groups would be denied exemption.

Note: A child care organization seeking and meeting the requirements of IRC section 170(b)(1)(A)(ii) would be subject to the provisions of Rev. Proc. 75-50.
A child care organization is subject to the same requirements for exemption and foundation status as other IRC section 501(c)(3) applicants.

In most cases, a child care organization which receives the majority of its funding from fees for child care services will satisfy the requirements for a foundation classification IRC section 509(a)(2).
## Vocational Schools

<table>
<thead>
<tr>
<th>Considered to Promote Education</th>
<th>The following are examples of why and when vocational schools are considered to promote education:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. An organization providing education and vocational training for unemployed and underemployed individuals by manufacturing and selling toy products qualifies under IRC section 501(c)(3) as a charitable and educational organization. (Rev. Rul. 73-128, 1973-1 C.B. 222)</td>
</tr>
<tr>
<td></td>
<td>2. A non-profit organization created through collective bargaining agreements to train individuals desiring to acquire skills in an industry is advancing education and exempt as a charitable and educational organization. (Rev. Rul. 72-101, 1972-1 C.B. 144)</td>
</tr>
<tr>
<td></td>
<td>3. An organization that marketed products made by the blind was held exempt under IRC section 501(c)(3) even though the net profits from the sales were distributed to the blind workers. The court held that while the net earnings went to individuals the purpose of providing employment to the blind alleviated the hardship these handicapped individuals experienced in securing and holding employment. <em>(Industrial Aid for the Blind v. Commissioner, 73 T.C. 96 (1979))</em></td>
</tr>
</tbody>
</table>
Student-Operated Businesses

Overview and Guidance

Student-operated businesses may qualify for exemption under IRC section 501(c)(3). However, in order to qualify for exemption, the primary purpose of the organization must be educational and the operation of the activity should be distinguishable from a regularly carried on trade or business.

Generally, in qualified educational programs, students will participate for a limited period of time. When they are finished with their training, they are replaced by a new group of trainees as distinguished from a continuing business with a permanent work force. Additional information can be found in IRM 7.25.3.7.8.

Examples

The following are examples of why and when student-operated businesses are considered to promote education:

- An organization that provided funds to a vocational training center and purchased lots, built homes, and sold the homes at fair market value and used the funds to finance new projects and obtain vocational training equipment for the public school system was held to be advancing education. (Rev. Rul. 76-37, 1976-1 C.B. 148)

- An organization that published a student operated campus newspaper qualified for exemption as educational. The ruling deals with political issues but identifies many factors that indicate the activity is exclusively educational and qualified under IRC section 501(c)(3). (Rev. Rul. 72-513, 1972-2 C.B. 246)

Primary Purpose is Not Promoting Education

The following is an example of a student-operated business that is not considered to promote education:

The organization was formed to operate a low-cost retail grocery outlet and provide job training for unemployed residents in the community. The organization operated in a manner similar to profit-making businesses in the area, except that groceries were sold at below market prices. Nearly all of the store's gross earnings were used to pay salaries, operating expenses, and to expand the operations of the store. Although the job training program was considered charitable, it was not the organization's primary activity. Accordingly, the organization does not qualify for recognition of exemption from Federal income tax under IRC section 501(c)(3). (Rev. Rul. 73-127, 1973-1 C.B. 221, 1973)
In Furtherance of Education?

Other Activities Considered Educational Under 501(c)(3) The following are some types of activities that may qualify as educational because they are conducted for the furtherance of education:

- University bookstores  (Rev. Rul. 58-194, 1958-1 C.B. 240)
- Organization selling school supplies to students and faculty  (Rev. Rul. 58-194, 1958-1 C.B. 240)
- Operation of a cafeteria for the benefit of students and faculty  (Rev. Rul. 58-194, 1958-1 C.B. 240)
- Organization formed by university to give business students experience in managing portfolios  (Rev. Rul. 68-16, 1968-1 C.B. 246)
- An alumni association was held exempt as an educational organization even though it is engaged in social and recreational activities, because those activities were found to be incidental to its exempt purpose (advancing the interests of the university)  (Rev. Rul. 60-143, 1960-1 C.B. 192)

Continued on next page
In Furtherance of Education?, Continued

Fraternities and Student Clubs

Two common types of organizations that are an integral part of the education community generally do not qualify as organizations operated exclusively in support of education. They are:

- Fraternities
- Student Clubs

Instructor Notes

Explain fraternities are generally exempt under 501(c)(7)

Fraternities

Fraternities are not considered to be organizations operated exclusively in support of education for these reasons:

- The activities of a fraternity in large part serve social purposes even though they are related to a university and have some educational aspects. (Rev. Rul. 69-573, 1969-2 C.B. 125)
- Their contribution to education is not central to the university’s educational program.

Student Clubs

Student clubs will not be considered exclusively operated in support of education when:

- Their activities, criteria for membership, or other aspects of their operations reflect purposes that are not considered exclusively educational. (Rev. Rul. 73-439, 1973-2 C.B. 176)
- However, the mere limiting of availability of its program to a relatively small membership of a restricted class will not preclude exemption as an organization operated exclusively in support of education. (Rev. Rul. 56-403, 1956-2 C.B. 307)
- Student clubs whose proposed activities are truly educational in purpose may be recognized as organizations exclusively operated in support of education and qualify for exemption under IRC section 501(c)(3).

Continued on next page
In Furtherance of Education?

Services for Educational Institutions Qualify - Examples

Services for educational organizations may advance education and therefore, qualify for exemption under IRC section 501(c)(3). Some examples are:

- An organization created and controlled by a college or university that creates a network of computers to gather and disseminate only scientific and educational information to exempt members, faculties, and students furthers a charitable purpose by advancing education under IRC section 501(c)(3). (Rev. Rul. 74-614, 1974-2, C.B. 164)

- A non-profit organization of accredited educational institutions that prepares accreditation standards, identifies schools and colleges meeting these standards, and disseminates lists of accredited institutions qualifies as a charitable organization. (Rev. Rul. 74-146, 1974-146, C.B. 129)

- A non-profit organization acting as a clearinghouse and course coordinator by bringing together instructors and interested students in a community for purposes of instruction is advancing education and thus exempt under IRC section 501(c)(3). (Rev. Rul. 71-413, 1971-2 C.B. 228)
Scholarships and Grants

General

A number of exempt organizations include granting scholarships and educational grant programs as part of their proposed activities.

It is well established in the law of charities that scholarships and student loans are a charitable endeavor if they are granted on the basis of:

- Need, as in Rev. Rul. 66-103, 1966-1, C.B. 134
- Merit, as in Rev. Rul. 69-257, 1969-1, C.B. 151
  - And are not subordinate of private purposes

Awarding of scholarships solely to members of a single fraternity will not preclude exemption under IRC section 501(c)(3). (Rev. Rul 56-403, 1956-2 C.B. 307)

However, if the payments are made to pre-selected, specifically named individuals, exemption is precluded. (Rev. Rul. 67-367, 1967-2 C.B. 188)

Examples

1. The giving of scholarships and grants based on need or merit is a charitable activity. (Rev. Rul. 66-103, 1966-1 C.B. and 69-257, 1969-1, C.B. 151)

2. Loans to students at low or minimal rates of interest to enable them to complete their education are charitable activities when the loans are both secured and unsecured. (Rev. Rul. 63-220, 1963-2 C.B. 208 and 61-87, 1961-1 C.B. 188)

3. Student aid in the form of free housing, books, or supplies is considered the advancement of education. (Treas. Reg. 1.501(c)(3)-1(d)(2))

4. A national honor society organized to recognize scholastic achievement and to serve universities and colleges where chapters are established is advancing education. (Rev. Rul. 67-217, 1967-1 C.B. 150)

Continued on next page
Scholarships and Grants, Continued

| Instructor Notes | Explain that advance approval of scholarships during a determination vs after a determination is granted. Explain post-determination requests are A cases and are generally reserved for a specific group. An overview will be presented in Unit 1b. |

IRC 4945(g)  
Private foundations are required to receive advance approval of their grant-making procedures in order to insure the grants, awards, or loans do not constitute a taxable expenditure. This advance approval can be secured with the initial request for exemption or can be requested at such time as the private foundation anticipates awarding scholarships, fellowships or awards for the purpose of travel, study, or similar purposes. Approval of their grant-making procedures must be requested in advance.

IRC section 4945(g)(1)  
- Scholarships or fellowships to individuals for the purpose of study

IRC section 4945(g)(3)  
- Other grants, including loans, to an individual for travel, study or other similar purposes to achieve a specific objective, produce a report or similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill or talent.

IRC section 4945(g)(2)  
- The grant constitutes a prize or award, which is subject to the provisions of IRC section 74(b) without regard to paragraph (3) thereof, if the recipient of such prize or award is selected from the general public.

Organizations granting prizes or awards under 4945(g)(2) are not subject to the advance approval process. (Rev. Rul. 77-380, 1977-2 C.B. 419, 76-460, 1976-2 C.B. 371, and 75-393, 1975-2 C.B. 451)
Employer-Related Scholarship Programs

Many private companies have established private foundations to fund scholarship or loan programs for employees or their children. An employer-related grant program is a program that:

- treats some or all of the employees of a particular employer or their children as a group from which grantees will be selected for educational grants,
- limits the potential grantees for some or all of the educational grants to individuals who are employees or children of employees of a particular employer, or
- otherwise gives such individuals preference or priority over others being selected

Two relevant revenue procedures describe the requirements for company scholarships and loans.

- Rev. Proc. 76-47, 1976-2 C.B. 670 (clarified by Rev. Proc. 85-51, 1985-2 C.B. 717), deals with requirements that must be met for the scholarship to meet the requirements of IRC section 117 and therefore not be taxable income to the recipient of the grant.
- Rev. Proc. 80-39, 1980-2 C.B. 772, deals with the requirements that must be met for loans to qualify as disbursements that are not taxable expenditures under IRC section 4945(g).

Note: As the requirements for employer-related loans under Rev. Proc. 80-39 (conditions and percentage test) are basically the same as the requirements for scholarships under Rev. Proc. 76-47, only Rev. Proc. 76-47 will be discussed in this lesson.

Continued on next page
The requirements set forth in the Rev. Proc. 76-47 are based on the assumption that the eligible group of recipients is sufficiently broad to qualify under IRC section 117. Although there is no absolute number to define “sufficiently broad,” if the sponsoring company is very small you should consult your manager.

Section 4 of Rev. Proc. 76-47 sets forth seven conditions which must be met as well as a percentage test in order for a ruling to be made that employer grants awarded are scholarships or fellowship grants under IRC section 117.

The seven conditions are as follows:

1. Inducement: the employer-related scholarship program must not be used by the employer and the private foundation as an inducement to recruit or retain employees to continue their employment;

2. Selection Committee: must be comprised of individuals totally independent and separate from the private foundation and the employer. These individuals may not be employees or former employees and should be knowledgeable in the educational field;

3. Eligibility Requirements: must be related to the purpose of the grant program. Potential recipients must be able to meet the admission requirements of and attend an educational institution. Eligibility must not be related to any other employment-related factors, such as the employee’s position, services, or duties. If a minimum period of employment is required to qualify for such scholarships, this period may not exceed three years;

4. Objective Standard: selection must be based solely upon objective standards that are unrelated to employment of the recipient (or his/her parents) or to the employer's line of business;

Continued on next page
Employer-Related Scholarship Programs, Continued

Seven Conditions (continued)

5. Employment: once awarded, a scholarship (and its renewal, if applicable) may not be terminated if the recipient (or his/her parents) is no longer employed with that employer;

6. Course of Study: the courses of study for which the scholarship are available must not be limited to those that would benefit the employer or the private foundation; and

7. Other Requirements: the employer-related scholarship program must meet all other requirements of IRC section 117 and the regulations.

Percentage Test

In addition to the seven requirements above, Rev. Proc. 76-47 requires that the program meet a percentage test.

- Percentage Test – Employees’ Children: if the employer-related scholarship program provides grants to employees’ children, the scholarships awarded must not exceed: (i) 25% of the number of employees' children who were eligible, applied for scholarships, and were considered by the selection committee in selecting the recipients; or (ii) 10% of the number of employees' children who were eligible (whether or not they submitted an application) in that year. (See Rev. Proc. 85-51, 1985-2 C.B. 717 for requirements in determining the number of employees' children who can be eligible recipients for purposes of the 10% test)

- Percentage Test – Employees: If the employer-related scholarship program provides grants to employees, the scholarships awarded must not exceed 10% of the number of employees who were eligible, were applicants for such grants, and were considered by the selection committee in selecting the recipients of grants in that year.
Employer-Related Scholarship Programs, Continued

Facts and Circumstances

If the employer-related scholarship program satisfies the seven conditions but not the percentage test, the program may nevertheless qualify if, in view of all the facts and circumstances, its primary purpose is to educate recipients in their individual capacities. Section 4 of the revenue procedure lists facts and circumstances test requirements.

Examples of application of the facts and circumstances test are found in Rev. Rul. 86-90, 1986-2 C.B. 184, which discusses a program involving one scholarship awarded to a child in an employee pool of thousands, and Rev. Rul. 2003-32, 2003-1 C.B. 689, which discusses grants awarded to employees or their children who are victims of a qualified disaster. Applications from private foundations that rely on the facts and circumstances test for qualification should be discussed with your manager.

Additional Guidance

For specific examples of employer-related scholarships, see the following revenue rulings:

- Rev. Rul. 79-131, 1979-1 C.B. 368, holds that an employer funded scholarship program for all students in a community is not an employer-related grant program as defined in Rev. Proc. 76-47.
- Rev. Rul. 79-365, 1979-2 C.B. 389, holds that a private foundation's scholarship program for children of deceased or retired employees is within the scope of Rev. Proc. 76-47.
- Rev. Proc. 94-78, 1994-2 C.B. 833, permits rounding off of the number of employer-related scholarship or loan grants.
- Rev. Proc. 80-39, 1980-2 C.B. 772, discusses employer-related short or long-term educational loans. (As noted before, the conditions and the percentage test of Rev. Proc. 80-39 are basically the same as the requirements of Rev. Proc. 76-47.)
Employer-Related Scholarship Programs, Continued

Private foundation EDS determination letters require selective paragraphs to recognize approval of employer-related individual grant programs. The current selective paragraphs are as follows:

- employer-related scholarships only: 3243, and 3244.
- employer-related loans only: 3254 and 3255.
- employer-related programs with both scholarships and loans: 3265 and 3266.

Additional Resources:
IRM 7.27.19.1 (Overview of taxable expenditures)
IRM 7.27.19.5 (Grants to individuals)
IRM 7.27.19.5.8.5 (Employer related programs)
NERD Drive (4945(g) procedures)
This lesson focused on "traditional" private schools requesting exemption under IRC section 501(c)(3) and classification as a school as defined in IRC section 170(b)(1)(A)(ii). Traditional doesn’t include charter or internet schools.

An organization requesting foundation classification as a school under IRC section 170(b)(1)(A)(ii) must meet the following criteria:

- present formal instruction as its "primary" function
- present a regularly scheduled curriculum
- maintain a regular faculty of qualified teachers
- have a regularly enrolled student body
- have facilities where its educational activities are regularly carried on

In order to normally maintain a regular curriculum a school must have course of study that is offered on a recurrent basis. A regular faculty is maintained if an organization has qualified teachers instruct students on a regular basis. A school must have a regularly enrolled student body and a facility where the activities are carried on. An organization can receive exemption as a school even if they are not in operation yet. They may receive exemption as a school if the proposed activities are described in sufficient detail.

An organization whose activities are educational in the broad sense, and which also maintains an educational institution in the nature of a school as a secondary or incidental activity, does not qualify under IRC section 170(b)(1)(A)(ii).

All educational organizations classified under IRC section 170(b)(1)(A)(ii) must have racially nondiscriminatory policies as to students to qualify under IRC section 501(c)(3). Rev. Proc. 75-50 sets forth guidelines and recordkeeping requirements.

Generally all organizations receiving school status are required to file form 990 unless they meet one of the exceptions described under IRC section 6033(a)(3).
Summary, Continued

Childcare organizations may qualify for exemption if the services are provided to the general public and if the care provided by the organization is for the purpose of enabling individuals to be gainfully employed.

Student-operated businesses may qualify for exemption under IRC section 501(c)(3). However, in order to qualify for exemption, the primary purpose of the organization must be educational and the operation of the activity should be distinguishable from a regularly carried on trade or business.

It is well established in the law of charities that scholarships and student loans are a charitable endeavor if they are granted on the basis of need or merit. Employer-Related Scholarship programs are subject to certain requirements and limitations.

| Instructor Notes | Class Exercise: Administer and go over answers to Class Exercise 12C-1 |
Private School Determination Case Checksheet

Name of Organization -

This checklist is to be used to classify applications for recognition of exemption from Federal income tax under § 501(c)(3) filed by private elementary or secondary schools and organizations that support such schools.

If at least one question in category A and one question in category B are answered affirmatively, call the EO Technical private school contact person listed below.

Meghan Biss (202-283-8945) or Jim Zelasko (202-283-8881)

If the application for exemption does not provide enough information to answer a particular question, the area office should request the information from the organization, or other appropriate source, as discussed with technical contact personnel. Specialists are strongly encouraged to call the EO Technical contact person for informal assistance in developing & analyzing private school cases.

**Category A**

1. Is the applicant organization a private elementary or secondary school?
   - Yes  
   - No
2. Does the applicant organization support the activities of a private elementary or secondary school(s)?
   - Yes  
   - No

**Category B**

1. Is the applicant located in Mississippi or Louisiana?
   - Yes  
   - No
2. Has the applicant ever been denied exemption?
   - Yes  
   - No
3. Has the applicant ever had previous § 501(c)(3) status revoked?
   - Yes  
   - No
4. Has the applicant ever been described or adjudicated as racially discriminatory by a court or governmental administrative body?
   - Yes  
   - No
5. Was the applicant formed at the time of public school desegregation?
   - Yes  
   - No
6. Are there any indications of actual racial discrimination present (third part complaints, etc.)
   - Yes  
   - No
7. Did the applicant operate as a taxable organization prior to filing its application for exemption?
   - Yes  
   - No
8. Is the applicant a successor organization to an organization described in questions 2 through 7?
   - Yes  
   - No
9. Is the applicant supporting one or more organizations described in questions 1 through 8?
   - Yes  
   - No

This checksheet should be placed on the left side of the folder directly behind the Memo to File.
School Worksheet
Rev. Proc. 75-50

a. Section 4.01 - Racially non-discriminatory policy statement must be in one of the following:

• Articles of Incorporation or Amendments thereto
• Bylaws or other governing instrument
• Resolution, signed and dated by the members of the governing body

Give location in file

b. Section 4.02 - Do copies of any brochures, application forms, advertisements and catalogues dealing with student admissions, programs and scholarships, as well as representative copies of all written advertising used as a means of informing prospective students of programs contain a statement of racially nondiscriminatory policy?

Yes ☐ No ☐

If not, is there a statement signed by one of the principal officers that future literature will contain the required statement?

Yes ☐ No ☐

Give location in file

c. Section 4.03 - Do we have the entire page of the newspaper in which the non-discriminatory policy was published?

Yes ☐ No ☐

Does the notice contain the proper caption, wording and size of type?

Yes ☐ No ☐

Give location in file
d. Section 5.01-1 - Is there a numerical schedule showing the racial composition for the current academic year, and projected as far as may be feasible for the next academic year, of: (a) the student body, (b) faculty, and (c) administrative staff?

Yes [ ] No [ ]

Give location in file

---

e. Section 5.01-2 - Is there a schedule providing the number and amount of loans and scholarships awarded to students enrolled by racial-ethnic categories?

Yes [ ] No [ ] *N/A [ ]

(*If no loans or scholarships awarded)

If yes, give location in file

---

f. Section 5.01-3 Is there a list of incorporators, founders, board members, and donors of land or buildings?

Yes [ ] No [ ]

Give location in file

---

g. Section 5.01-4 - Is there a statement indicating whether any incorporators, founders, board members, and donors of land or buildings have an objective to maintain segregated public or private school education?

Yes [ ] No [ ]

Give location in file

---
h. Section 7 - Is there a statement signed by one of the officers that records will be maintained in accordance with Rev. Proc. 75-50?

Yes ☐ No ☐

Give location in file

This worksheet should be placed on the left side of the folder directly behind Private School Checksheet.
SECTION 1. PURPOSE

.01 This Revenue Procedure sets forth guidelines and recordkeeping requirements for determining whether private schools that are applying for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, or are presently recognized as exempt from tax, have racially nondiscriminatory policies as to students.

SECTION 2. BACKGROUND

.01 A school that does not have a racially nondiscriminatory policy as to students does not qualify as an organization exempt from Federal income tax. Rev. Rul. 71-447, 1971-2 C.B. 230.

.02 A school must show affirmatively both that it has adopted a racially nondiscriminatory policy as to students that is made known to the general public and that since the adoption of that policy it has operated in a bona fide manner in accordance therewith.

.03 Internal Revenue Service experience with private schools has shown a need for more specific guidelines to insure a uniform approach to the determination of whether a private school has a racially nondiscriminatory policy as to students.

.04 This Revenue Procedure does not apply to public schools.

SECTION 3. DEFINITIONS

.01 Rev. Rul. 71-447 states that a racially nondiscriminatory policy as to students means:

- the school admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school and that the school does not discriminate on the basis of race in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.
.02 The Service considers discrimination on the basis of race to include discrimination on the basis of color and national or ethnic origin. A policy of a school that favors racial minority groups with respect to admissions, facilities and programs, and financial assistance will not constitute discrimination on the basis of race when the purpose and effect is to promote the establishment and maintenance of that school's racially nondiscriminatory policy as to students.

.03 A school that selects students on the basis of membership in a religious denomination or unit thereof will not be deemed to have a discriminatory policy if membership in the denomination or unit is open to all on a racially nondiscriminatory basis.

.04 For purposes of this revenue procedure, the term "school" has the same meaning it has in section 170(b)(1)(A)(ii) of the Code.

SECTION 4. GUIDELINES.

.01 Organizational requirements. A school must include a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy as to students and therefore does not discriminate against applicants and students on the basis of race, color, and national or ethnic origin.

.02 Statement of Policy. Every school must include a statement of its racially nondiscriminatory policy as to students in all its brochures and catalogues dealing with student admissions, programs, and scholarships. A statement substantially similar to the Notice described in subsection (a) of section 4.03, infra, will be acceptable for this purpose. Further, every school must include a reference to its racially nondiscriminatory policy in other written advertising that it uses as a means of informing prospective students of its programs. The following references will be acceptable:

The M school admits students of any race, color, and national or ethnic origin.

.03 Publicity. The school must make its racially nondiscriminatory policy known to all segments of the general community served by the school.

1 The school must use one of the following two methods to satisfy this requirement:

(a) The school may publish a notice of its racially nondiscriminatory policy in a newspaper of general circulation that serves all racial segments of the community. This publication must be repeated at least once annually during the period of the school's solicitation for students or, in the absence of a solicitation program, during the school's registration period. Where more than one community is served by a school, the school may publish its notice in those newspapers that are reasonably likely to be read by all racial segments of the communities that it serves. The notice must appear in a section of the newspaper likely to be read by prospective students and their families and it must occupy at least three column inches. It must be
captioned in at least 12 point bold face type as a notice of nondiscriminatory policy as to students, and its text must be printed in at least 8 point type.

The following notice will be acceptable:

NOTICE OF NONDISCRIMINATORY POLICY AS TO STUDENTS

The M school admits students of any race, color, national and ethnic origin to all the rights, privileges, programs, and activities generally accorded or made available to students at the school. It does not discriminate on the basis of race, color, national and ethnic origin in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.

(b) The school may use the broadcast media to publicize its racially nondiscriminatory policy if this use makes such nondiscriminatory policy known to all segments of the general community the school serves. If this method is chosen, the school must provide documentation that the means by which this policy was communicated to all segments of the general community was reasonably expected to be effective. In this case, appropriate documentation would include copies of the tapes or script used and records showing that there was an adequate number of announcements, that they were made during hours when the announcements were likely to be communicated to all segments of the general community, that they were of sufficient duration to convey the message clearly, and that they were broadcast on radio or television stations likely to be listened to by substantial numbers of members of all racial segments of the general community. Announcements must be made during the period of the school's solicitation for students or, in the absence of a solicitation program, during the school's registration period.

Communication of a racially nondiscriminatory policy as to students by a school to leaders of racial groups as the sole means of publicity generally will not be considered effective to make the policy known to all segments of the community.

2 The requirements of subsection 1 of this section will not apply when one of the following paragraphs applies:

(a) If for the preceding three years the enrollment of a parochial or other church-related school consists of students at least 75 percent of whom are members of the sponsoring religious denomination or unit, the school may make known its racially nondiscriminatory policy in whatever newspapers or circulars the religious denomination or unit utilizes in the communities from which the students are drawn. These newspapers and circulars may be those distributed by a particular religious denomination or unit or by an association that represents a number of religious organizations of the same denomination. If, however, the school advertises in newspapers of general circulation in the community or communities from which its students are drawn and paragraphs (b) and (c) of this subsection are not applicable to it, then it must comply with paragraph (a) of subsection 1 of this section.
(b) If a school customarily draws a substantial percentage of its students nationwide or worldwide or from a large geographic section or sections of the United States and follows a racially nondiscriminatory policy as to students, the publicity requirement may be satisfied by complying with section 4.02, supra. Such a school may demonstrate that it follows a racially nondiscriminatory policy within the meaning of the preceding sentence either by showing that it currently enrolls students of racial minority groups in meaningful numbers or, when minority students are not enrolled in meaningful numbers, that its promotional activities and recruiting efforts in each geographic area were reasonably designed to inform students of all racial segments in the general communities within the area of the availability of the school. The question whether a school satisfies the preceding sentence will be determined on the basis of the facts and circumstances of each case.

(c) If a school customarily draws its students from local communities and follows a racially nondiscriminatory policy as to students, the publicity requirement may be satisfied by complying with section 4.02, supra. Such a school may demonstrate that it follows a racially nondiscriminatory policy within the meaning of the preceding sentence by showing that it currently enrolls students of racial minority groups in meaningful numbers. The question whether a school satisfies the preceding sentence will be determined on the basis of the facts and circumstances of each case. One of the facts and circumstances that the Service will consider is whether the school's promotional activities and recruiting efforts in each area were reasonably designed to inform students of all racial segments in the general communities within the area of the availability of the school. The Service recognizes that the failure by a school drawing its students from local communities to enroll racial minority group students may not necessarily indicate the absence of a racially nondiscriminatory policy as to students when there are relatively few or no such students in these communities. Actual enrollment is, however, a meaningful indication of a racially nondiscriminatory policy in a community in which a public school or schools became subject to a desegregation order of a federal court or otherwise expressly became obligated to implement a desegregation plan under the terms of any written contract or other commitment to which any Federal agency was a party.

The Service encourages schools to satisfy the publicity requirement by the methods described in subsection 1 of this section, regardless of whether a school considers itself within subsection 2, because it believes these methods to be the most effective to make known a school's racially nondiscriminatory policy. In this regard it is each school's responsibility to determine whether paragraph (a), (b), or (c) of subsection 2 applies to it. On audit, a school must be prepared to demonstrate that the failure to publish its racially nondiscriminatory policy in accordance with subsection 1 of this section was justified by the application to it of paragraph (a), (b), or (c) of subsection 2. Further, a school must be prepared to demonstrate that it has publicly disavowed or repudiated any statements purported to have been made on its behalf (after November 6, 1975) that are contrary to its publicity of a racially nondiscriminatory policy as to students, to the extent that the school or its principal official were aware of such statements.
.04 Facilities and Programs. A school must be able to show that all of its programs and facilities are operated in a racially nondiscriminatory manner.

.05 Scholarship and loan programs. As a general rule, all scholarship or other comparable benefits procurable for use at any given school must be offered on a racially nondiscriminatory basis. Their availability on this basis must be known throughout the general community being served by the school and should be referred to in the publicity required by this section in order for that school to be considered racially nondiscriminatory as to students. Consistent with section 3.02, supra, scholarships and loans that are made pursuant to financial assistance programs favoring members of one or more racial minority groups that are designed to promote a school's racially nondiscriminatory policy will not adversely affect the school's exempt status.

Financial assistance programs favoring members of one or more racial groups that do not significantly derogate from the school's racially nondiscriminatory policy similarly will not adversely affect the school's exempt status.

.06 Certification. An individual authorized to take official action on behalf of a school that claims to be racially nondiscriminatory as to students must certify annually, under penalties of perjury, on an Internal Revenue form to be issued, that to best of his knowledge and belief the school has satisfied the applicable requirements of sections 4.01 through 4.05 of this Revenue Procedure.

.07 Faculty and Staff. The existence of a racially discriminatory policy with respect to employment of faculty and administrative staff is indicative of a racially discriminatory policy as to students. Conversely, the absence of racial discrimination in employment of faculty and administrative staff is indicative of a racially nondiscriminatory policy as to students.

.08 Failure to comply. Failure to comply with the guidelines will ordinarily result in the proposed revocation of the exempt status of a school in accordance with the procedures set forth in Rev. Proc. 72-4, 1972-1 C.B. 706.

SEC. 5. APPLICATIONS FOR TAX EXEMPT STATUS.

.01 Information required to be submitted. Every school filing an application for recognition of a tax exempt status must supply the Service with the following information:

1 Racial composition, as of the current academic year and projected so far as may be feasible for the subsequent academic year, of--

(a) Student body, and

(b) Faculty and administrative staff.
2 Amount of scholarship and loan funds, if any, awarded to students enrolled and racial composition of students who have received such awards.

3 A listing of incorporators, founders, board members, and donors of land or buildings, whether individuals or organizations.

4 A statement whether any of the organizations described in subsection .01-3 of this section have at the time the application is filed an objective of maintaining segregated public or private school education and, if so, a statement whether any of the individuals described in subsection .01-3 of this section are officers or active members of such organizations at the time the application is filed.

5 Year of organization.

.02 Limitations.

1 For purposes of section 5.01, the racial composition of the student body, faculty, and administrative staff may be an estimate based on the best information readily available to the school, without requiring student applicants, students, faculty, or administrative staff to submit information to the school that the school otherwise does not require. However, a statement of the method by which the racial composition was determined must be supplied.

2 The information required to be submitted under section 5.01 should not identify individual students or members of the faculty and administrative staff.

SEC. 6. PUBLIC COMPLAINTS OF RACIAL DISCRIMINATION.

The Service is interested in receiving any information that an exempt private school is not operating under a racially nondiscriminatory policy as to students, including any judicial or administrative determinations to this effect. This information may be sent to the local District Director of Internal Revenue or to the Commissioner of Internal Revenue, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention E:EO.

SEC. 7. RECORDKEEPING REQUIREMENTS.

.01 Specific records. Except as provided in section 7.03, each exempt private school must maintain for a minimum period of three years, beginning with the year after the year of compilation or acquisition, the following records for the use of the Service on proper request:

1 Records indicating the racial composition of the student body, faculty, and administrative staff for each academic year.

2 Records sufficient to document that scholarship and other financial assistance is awarded on a racially nondiscriminatory basis.
3 Copies of all brochures, catalogues, and advertising dealing with student admissions, programs, and scholarships. Schools advertising nationally or in a large geographic segment or segments of the United States need only maintain a record sufficient to indicate when and in what publications their advertisements were placed.

4 Copies of all materials used by or on behalf of the school to solicit contributions.

.02 Limitation.

1 For purposes of section 7.01, the racial composition of the student body, faculty, and administrative staff may be an estimate based on the best information readily available to the school, without requiring student applicants, students, faculty, or administrative staff to submit information to the school that the school otherwise does not require. For each academic year, however, a record of the method by which racial composition is determined must be maintained. A school may not discontinue maintaining a system of records that reflects racial composition of students, faculty, and administrative staff used on November 6, 1975, unless it substitutes a different system that compiles substantially the same information, without the advance approval of the Internal Revenue Service.

2 The Service does not require that a school release personally identifiable records or personal information contained therein except in accordance with the requirements of the "Family Educational Rights and Privacy Act of 1974," 20 U.S.C. §1232g (1974). Similarly, the Service does not require a school to keep records the maintenance of which is prohibited under state or federal law.

.03 Exceptions. The records described in section 7.01 need not be independently maintained for Internal Revenue Service use if

1 Substantially the same information that each of these records would provide has been included in a report or reports filed in accordance with law with an agency or agencies of Federal, state, or local government, and this information is current within one year, and

2 The school maintains copies of these reports from which this information is readily obtainable. Records described in section 7.01 providing information not included in reports filed with an agency or agencies must be maintained by the school for Service use.

.04 Failure to maintain records. Failure to maintain or to produce upon the proper request the required records and information will create a presumption that the organization has failed to comply with these guidelines.
SEC. 8. MISSISSIPPI SCHOOLS.

The United States District Court for the District of Columbia has ordered specific guidelines and recordkeeping requirements for Mississippi private schools. Green v. Connally, 330 F. Supp. 1150, aff'd. sub nom. Coit v. Green, 404 U.S. 997 (1971). To the extent that the requirements of the Court's Order vary from the guidelines and recordkeeping requirements set forth in this Revenue Procedure, the Court's Order is controlling for Mississippi schools.

SEC. 9. EFFECTIVE DATE.

.01 Section 4.02 is not applicable until February 4, 1976.

.02 To the extent that the publicity requirements set forth in section 4.03, supra, differ from those set forth in Rev. Proc. 72-54, 1972-2 C.B. 834, they shall not be effective until a school's first period of solicitation for students or, in the absence of a solicitation program, during the school's first registration period beginning after November 6, 1975.

.03 The recordkeeping requirements set forth in section 7, supra, shall not be effective until January 1, 1976.

SEC. 10. EFFECTIVE ON OTHER DOCUMENTS.

Rev. Proc. 72-54 is superseded.

---------- [Footnotes] ----------

1 Also released as TIR-1417, dated Nov. 6, 1975.
1. Which of the following criteria must be present for an organization seeking tax exempt status as a school:

   (a) A regularly scheduled curriculum  
   (b) A regular faculty of qualified teachers  
   (c) A regularly enrolled student body  
   (d) Facilities where its educational activities are regularly carried on  
   (e) All of the above

   **Answer: (e)**

2. Would a museum that regularly holds monthly lectures and workshops qualify for school classification? Why or why not?

   **Answer: No.** As the primary activity of the organization is to operate a museum, the organization would not qualify as a school regardless of whether the monthly lectures met the school criteria for curriculum, faculty, student body, and facilities.

3. Which of the following Revenue Procedures applies to a non-discriminatory policy a school must have to be exempt?

   (a) Revenue Procedure 82-76  
   (b) Revenue Procedure 79-60  
   (c) Revenue Procedure 75-50  
   (d) Revenue Procedure 68-15

   **Answer: (c)**

4. It is acceptable for a school to publish its non-discriminatory policy in the legal section of the newspaper.

   (a) True  
   (b) False

   **Answer: False.** The notice must appear in a section of the newspaper likely to be read by prospective students and their families. Therefore, a notice published in the legal notices section or classified advertisements is generally not acceptable.
5. Ross Corporation’s employee daycare program may qualify for exemption under IRC section 501(k).

   (a) True    (b) False

   • **Answer: False** The services provided by the organization are not available to the general public as required under 501(k)

6. The giving of scholarships and grants based on need or merit is a charitable activity.

   (a) True    (b) False

   **Answer: True**

7. Ross Corporation’s employee scholarship program may qualify for exemption under IRC section 501(c)(3).

   (a) True    (b) False

   **Answer: True** Employer based scholarships may qualify for exemption under (c)(3) provided they meet the general requirements under 501(c)(3) and the specific requirements of Rev. Proc. 76-47 and 80-39.

8. Secular schools operated by churches are not subject to Rev. Proc. 75-50 non-discriminatory policies.

   (a) True    (b) False

   **Answer: False** Secular schools operated by churches are required to comply with 75-50. Purely religious schools (such as seminaries) are not subject to 75-50. (Secular schools operated by churches may be exempted from 990 filing requirements if they meet the requirements of Treas. Reg. 1.6033-2(g)(vii).)
Chapter 13
Lesson A
Public Charities, Private Foundations and Private Operating Foundations

Instructor Preparation

Estimated Time
3 hours

Reference Materials
- Instructor guide, Chapter 10, IRC Section 501(c)(3) – Charitable Organizations Purposes and Types
- Student Guide, Chapter 10, IRC Section 501(c)(3) – Charitable Organizations Purposes and Types

Training Aids
TA 13A-1, Objectives

Notes to Instructor
None
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Objectives

After completing this chapter you will be able to:

• Distinguish between a public charity and a private foundation

• Identify organizations that qualify for public charity classification under IRC Sections 509(a)(1), (2), (3) and (4)

• Identify “Disqualified Persons”
• Determine when a person becomes a “Substantial Contributor”

• Determine when a PF qualifies as a private operating foundation
Chapter 13
Lesson A
Public Charities, Private Foundations, and Private Operating Foundations

Overview

Instructor Notes
These lessons discuss the different foundation classifications for 501(c)(3) organizations. Classification as a church or school was discussed in previous lessons.

Introduction
Determining an organization’s foundation status can sometimes involve complex issues. Therefore, the discussion of foundation classification is divided into four lessons:

- Lesson 13A: Public Charities, Private Foundations and Private Operating Foundations
- Lesson 13B: 509(a)(1) Foundation Status
- Lesson 13C: 509(a)(2) Foundation Status
- Lesson 13D: 509(a)(3) Foundation Status Overview

This lesson introduces basic concepts needed to make a final determination as to an organization’s private foundation or public charity status. It also discusses a special type of private foundation, called a private operating foundation.

Continued on next page
Overview, Continued

Objectives
At the end of this lesson you will be able to:

- Distinguish between a public charity and a private foundation
- Identify organizations that qualify for public charity classification under IRC sections 509(a)(1), (2), (3), and (4)
- Identify “Disqualified Persons”
- Determine when a person becomes a “Substantial Contributor”
- Determine when a PF qualifies as a private operating foundation

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## Private Foundations

**Private Foundations Defined**

The Tax Reform Act of 1969 introduced the classification of “private foundation” into the Internal Revenue Code and added a wide array of restrictions, requirements, taxes, and penalties affecting organizations so classified (and certain people associated with them).

IRC 509(a) defines a private foundation as an organization, foreign or domestic, described in IRC section 501(c)(3) other than an organization described in IRC section 509(a)(1), (2), (3), or (4).

Thus, if an organization is described in IRC section 501(c)(3), it is a private foundation (PF) unless it falls into one of four general categories of organizations excluded under IRC sections 509(a)(1) through (4).

- **509(a)(1)** – publicly supported organizations described in IRC 170(b)(1)(A) other than clauses (vii) or (viii); IRC 170(b)(1)(A)(vi) publicly supported organizations are discussed in Lesson 13B
- **509(a)(2)** - publicly supported organizations are discussed in Lesson 13C
- **509(a)(3)** - supporting organizations are discussed in Lesson 13D
- **509(a)(4)** - organizations for testing public safety - if assigned, see group manager

### Instructor Notes

Emphasize that it is only after an organization has been determined to qualify for exemption under IRC section 501(c)(3) that we will become concerned with its foundation classification.

A private operating foundation (POF) is a special type of PF.
**Private Foundations, Continued**

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**Private Foundation Presumption**

IRC section 508(b) provides, generally, that a 501(c)(3) organization is presumed to be a private foundation unless it files a timely notice to the contrary with the Service. An organization ordinarily files its notice by timely filing a properly completed Form 1023 application.

The presumption of PF status is rebuttable. Even if the timely filing deadline is not met, the organization may subsequently submit information establishing its status as a public charity. (See Rev. Rul. 73-504, 1973-2 C.B. 190)

**Chapter 42 Taxes**

Generally, classification as a public charity is more desirable than PF status. Contributions to public charities are deductible to the extent of 50% of the donor’s adjusted gross income; contributions to private foundations are generally limited to 30% of the donor’s adjusted gross income.

Also, there is an excise tax imposed on the net investment income of most domestic private foundations. The Code contains five provisions that impose two-tier excise taxes on private foundations, foundation managers, or other disqualified persons that engage in certain prohibited acts. The rules governing these code provisions can be very complex.

*Continued on next page*
These excise taxes are described in:

- IRC section 4940 - tax on net investment income
- IRC section 4941 - tax on self dealing
- IRC section 4942 - tax on failure to distribute income
- IRC section 4943 - tax on excess business holdings
- IRC section 4944 - tax on jeopardizing investments
- IRC section 4945 - tax on taxable expenditures

A PF also has to annually file Form 990-PF, a much more detailed information return than Form 990.

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Private Foundations, Continued

Chapter 42 Taxes (continued)

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- IRC section 4944 - tax on jeopardizing investments
- IRC section 4945 - tax on taxable expenditures

A PF also has to annually file Form 990-PF, a much more detailed information return than Form 990.

Instructor Notes

Discuss where information is found in the 1023 which would indicate PF status rather than public charity.

Common Characteristics of Private Foundations

Common characteristics of private foundations include funding from limited sources (e.g., an individual, family, or business); tightly controlled board or governing body (often the donor or family members); future revenues from investment income or additional donations from the creator; and activities consisting of distributing funds to other charitable organizations or making grants to individuals.

As previously mentioned, private foundations are organizations which fail to meet an exception to the general rule. The overall purpose of the exceptions is to identify organizations which have sufficiently strong public oversight, control and funding so that they do not need to be closely governed by the very specific and detailed rules of Chapter 42.
Types of Public Charity Classifications

Instructor Notes

(iv) – emphasize used for endowment funds only – not alumni chapters

Q. Why we are concerned about PF status?

A. If an organization is dominated by a small group of people it can be subject to abuse.

Students read IRC section 509.

Public Charity Classifications

If the applicant organization indicates that it is not a private foundation on Form 1023, Part X, 1a on page 10, it must answer item 5 and indicate which of the following charity classifications is most appropriate:

a. IRC sections 509(a)(1) and 170(b)(1)(A)(i)
   Church or a convention or association of churches (Lesson 10)

b. IRC sections 509(a)(1) and 170(b)(1)(A)(ii)
   School (Lesson 12-C)

c. IRC sections 509(a)(1) and 170(b)(1)(A)(iii)
   Hospital, cooperative hospital service organization or a medical research organization in conjunction with a hospital

d. IRC section 509(a)(3)
   An organization supporting either one or more organizations described in items a through c, f, g, or h (Lesson 13D)

e. IRC section 509(a)(4)
   An organization organized and operated exclusively for testing for public safety (if assigned, see group manager)

Continued on next page
| Public Charity Classifications (continued) | f. IRC sections 509(a)(1) and 170(b)(1)(A)(iv)  
An organization operated for the benefit of a college or university that is owned or operated by a governmental unit (if assigned, see group manager) |
| g. IRC sections 509(a)(1) and 170(b)(1)(A)(vi)  
An organization receiving a substantial part of its support in the form of contributions from publicly supported organizations, from a governmental unit, or from the general public (Lesson 13B) |
| h. IRC section 509(a)(2) An organization receiving not more than one-third of its support gross investment income and more than one-third of its support from contributions, membership fees, and gross receipts from activities related to its exempt functions (Lesson 13C) |
Disqualified Persons

The term “disqualified person” (DQP) has a direct impact on the treatment and status of private foundations in several situations. It is important in determining a PF’s potential liability for many of the Chapter 42 excise taxes and is also used in determining whether or not an organization qualifies for public charity status. It plays an important part in the IRC section 509(a)(2) support test because amounts from DQPs are not included in the support test. The PF exception under IRC section 509(a)(3) precludes control by a DQP.

A disqualified person is defined under IRC section 4946 as an individual falling into one of five general categories and two special purpose categories as follows:

- Substantial Contributor
- Foundation Manager (An officer, director, trustee or an individual having powers or responsibilities similar to those of an officer, director, or trustee of the organization)
- Owner of more than 20% interest of an organization that is a substantial contributor to the foundation
- Family members of the above (spouse, ancestors, descendants, and spouse of lineal descendants)

Continued on next page
Disqualified Persons, Continued

- An organization in which persons described above hold more than a 35% interest

- A PF which is effectively controlled by the person or persons in control of the PF (only for IRC section 4943, excess business holdings)

- A government official (only for IRC section 4941, self dealing)

IRC section 4946, the regulations, and IRM 7.27.20 provide comprehensive examples of the above categories of disqualified persons. DQPs are not always easily identifiable in the application. Probing questions are sometimes required to identify relationships or control.

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Continued on next page
Disqualified Persons, Continued

- Family members of the above (spouse, ancestors, descendants, and spouse of lineal descendants)
- An organization in which persons described above hold more than a 35% interest
- A PF which is effectively controlled by the person or persons in control of the PF (only for IRC section 4943, excess business holdings)
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IRC section 4946, the regulations, and IRM 7.27.20 provide comprehensive examples of the above categories of disqualified persons. DQPs are not always easily identifiable in the application. Probing questions are sometimes required to identify relationships or control.
Substantial Contributor

Treas. Reg. 1.507-6 defines a substantial contributor. A substantial contributor is any person who contributes an amount of more than $5,000 to the organization, if such amount is more than 2% of the total contributions received by the organization before the close of the taxable year in which the contribution is received from such a person.

For a trust, the creator is a “substantial contributor” regardless of the contribution amount.

Although the determination of the percentage of total contributions by an individual’s contributions is not made until the end of the PF’s taxable year, a donor is a substantial contributor as of the first date the $5,000/2% threshold is exceeded.

Once a person is a substantial contributor, with respect to a private foundation, they remain a substantial contributor even though they might not be so classified if a determination were first made at some later date.

Example 1:

On January 1, 2004, A, an individual, gave $4,500 to M, a private foundation on a calendar year basis. On June 1, 2005, A gave M the further sum of $1,500. The total amount of contributions received by M throughout its existence as of December 31, 2004, was $150,000. The total amount of contributions received through December 31, 2005 was $295,000. A did not become a substantial contributor to M in 2004. As of June 1, 2005, A is a substantial contributor to M.
**Substantial Contributor, Continued**

**Example 2:**

On July 20, 2004, B, an individual, gave $2,000 to M, a private foundation on a calendar year basis. On August 1, 2005, B gave M the further sum of $3,100. The total amount of contributions received by M throughout its existence as of December 31, 2004, was $150,000. The total amount of contributions received throughout its existence as of August 1, 2005 was $245,000. The total amount of contributions received through December 31, 2005 was $295,000. B is not a substantial contributor to M in 2005 even though his aggregate contributions ($2,000 and $3,100) exceeded the $5,000/2% of the PF’s total contributions as of August 1 (2% * $245,000 = $4,900). B’s total contributions did not exceed the 2% of the PF’s total contributions as of December 31, 2005 (2% * $295,000 = $5,900).

---

**Instructor Notes**

Go over the examples in text.

---

**Aggregate Contributions**

The aggregate contributions by a person to a PF may become less than 2 percent of the total contributions received (from all sources) by the foundation by reason of additional contributions made by others, yet such person remains a substantial contributor.

**Example:**

Assume the same facts as in the previous two examples. On March 25, 2006, M received two contributions totaling one million dollars. There were no other contributions made during 2006. Even though A’s aggregate contributions ($4,500 + $1,500) are less than 2% of the total aggregate contributions received by the PF as of December 31, 2006 (2% of $1,295,000), he remains a substantial contributor to M.
Private Operating Foundations

Instructor Notes

Explain that organizations may request POF status on the 1023; however, the specialist must determine if they meet the requirements for POF classification, if they are better classified as public charities or whether they are PFs.

PF v. POF

If an organization is a private foundation, it must indicate on its application for exemption whether it is a private non-operating foundation or a private operating foundation (POF). A POF devotes most of its earnings and uses most of its assets to directly conduct its own tax exempt purposes, for example, a museum, library or research organization. POFs are defined in IRC section 4942(j)(3) and discussed in IRM 7.26.6.

Instructor Notes

Have students read IRM 7.26.6.2 for other POF advantages.

POF Advantages

Some of the advantages of private operating foundation status are:

- They are not subject to the excise tax on failure to distribute income
- Contributions to POFs are deductible by the donors to the extent of 50% of the donor’s adjusted gross income, whereas contributions to other private foundations are generally limited to 30% of the donor’s adjusted gross income
- A POF may receive qualifying distributions from a private foundation if the private foundation does not control it

Continued on next page
Private Operating Foundations, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain if the organization has greater than one year’s operating experience, it must provide financial statements to show how the tests are met.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Emphasize direct conduct of exempt activities.</td>
</tr>
</tbody>
</table>

Private Operating Foundation Defined

A private operating foundation is any private foundation that spends at least 85% of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of its exempt purposes (income test), and that, in addition, meets one of the following tests:

- Assets test
- Endowment test or
- Support test

The tests are applied each year (on the basis of operations over the past three or four years). Thus, a private foundation might qualify as an operating foundation in year 1 but not year 2, in which case the foundation would need to meet the distribution requirements of IRC 4942 for year 2 or else be subject to the 4942 excise tax.

Continued on next page
Active Conduct of Exempt Activities

Directly for the active conduct of exempt activities refers to qualifying distributions a foundation makes that are used to conduct exempt activities by the foundation itself, rather than by or through grantee organization(s) that receive the distributions.

Grants to other organizations to help them conduct their activities are an indirect, rather than direct, means of carrying out the foundation's exempt purpose of the private foundation, even though the activities of the grantee organization may further the exempt activities of the grantor foundation.

Amounts paid to buy or maintain assets used directly in the conduct of the foundation’s exempt activities, such as the operating assets of a museum, public park, or historic site, are direct expenditures for the active conduct of the foundation’s exempt activities. Likewise, administrative expenses (such as staff salaries and traveling expenses) and other operating costs necessary to conduct the foundation’s exempt activities (regardless of whether they are directly for the active conduct of exempt activities) are treated as qualifying distributions expended directly for the active conduct of exempt activities if the expenses and costs are reasonable in amount.

However, administrative expenses and operating costs that are not for exempt activities, such as expenses in connection with the production of investment income, are not qualifying distributions. Expenses for both exempt and non-exempt activities will be allocated to each activity on a reasonable and consistently applied basis.

Continued on next page
### Private Operating Foundations, Continued

<table>
<thead>
<tr>
<th>Active Conduct of Exempt Activities (continued)</th>
</tr>
</thead>
<tbody>
<tr>
<td>An amount set aside by a foundation for a specific project, for example to buy and restore or build additional buildings or facilities that are to be used by the foundation directly for the active conduct of the foundation’s exempt activities, will be treated as qualifying distributions expended directly for the active conduct of the foundation’s exempt activities if the set-aside meets the requirements described in IRC section 4942(g)(2).</td>
</tr>
</tbody>
</table>

Treas. Reg. 53.4942(b)-1(b)(1) lists the standards for determining whether a foundation has made a particular distribution directly for the active conduct of its activities constituting its exempt purpose or function. (See also IRM 7.26.6.3.1.1)
Private Operating Foundations, Continued

| Instructor Notes | Review examples in Treas. Reg. 53.4942(b)-1(d). |

**Payments to Individuals**

Grants, scholarships, program-related investments, or other payments to individuals constitute direct exempt-function distributions only if the grantor foundation maintains some “significant involvement” in the active programs in support of which such grants are made. Treas. Reg. 53.4942(b)–1(b)(2)(i).

A foundation will be considered as maintaining a significant involvement in individual grant making if:

- An exempt purpose of the foundation is relief of the poor or distressed, and its activities provide such relief; the making of such grants is direct and without the assistance of an intervening organization or agency; and the foundation maintains a staff of administrators, researchers, or other personnel who supervise and direct these activities on a continuing basis. See Example (8) of Reg. 53.4942(b)–1(d); or

- The foundation has developed some specialized skills, expertise, or involvement in a particular substantive area; the foundation maintains a salaried staff of administrators, researchers, or other personnel who supervise and conduct programs in the foundation’s particular area of interest; and the foundation makes grants to individuals to further their involvement in the foundation’s programs (such as grants under which the recipients, in addition to independent study, attend classes, seminars, or conferences sponsored or conducted by the foundation, or grants to engage in social work projects under the general direction and supervision of the foundation). See Examples (3)–(7) and (9) of Treas. Reg. 53.4942(b)–1(d).
### Payments to Individuals (continued)

Whether grants, scholarships, or other payments are qualifying distributions made directly for the active conduct of the foundation’s exempt activities is determined by the facts and circumstances of each particular case. The test is a qualitative one. If the foundation maintains a significant involvement (as defined earlier), it will not fail to qualify just because more of its funds are devoted to grants, scholarships, or other payments than to the active programs that such grants, scholarships, or other payments support. (See also IRM 7.26.6.3.1.2)

If, however, a foundation does no more than select, screen, and investigate applicants for grants or scholarships, under which the recipients perform their work or studies alone or exclusively under the direction of another organization, the grants or scholarships will not be treated as qualifying distributions made directly for the active conduct of the foundation’s exempt activities. The administrative expenses of screening and investigating (as opposed to the grants or scholarships themselves) may be treated as qualifying distributions made directly for the active conduct of the foundation’s exempt activities.

*Continued on next page*
Private Operating Foundations, Continued

| Instructor Notes | Explain this financial information can be found or requested using Part XIV of 990-PF. |

Operating Foundation Tests

Determining whether the income test and one of the three remaining tests are met depends on whether the tests are met in a foundation's normal and regular operation over a period of years, rather than on a given day during the year or on a year-by-year basis. A foundation may qualify as an operating foundation if it meets the income test and either the assets, endowment, or support test for any three years during a four-year period (three-out-of-four year method), or based on a combination of all pertinent amounts of income or assets held, received, or distributed during the four-year period (four-year combination method). The four-year period consists of the tax year in question and the three years immediately preceding that year. A foundation may not use one method for satisfying the income test and the other method for satisfying one of the other tests.

For example, if the income test is satisfied on the three-out-of-four-year basis, the foundation may not use the four-year combination method to satisfy one of the other tests. However, that the foundation uses one method to satisfy the tests in a particular year will not prevent it from using the other method to satisfy the tests in a later year. If a foundation fails to satisfy the income test and either the assets, endowment, or support test for a particular tax year under either the three-out-of-four-year method or the combination method, it will be treated as a nonoperating foundation for the tax year and for all later tax years until it satisfies the tests.

Continued on next page
Private Operating Foundations, Continued

**Income Test**

To qualify as an operating foundation, the organization must make qualifying distributions directly for the active conduct of its exempt activities equal to substantially all (at least 85 percent) of the lesser of its:

- Adjusted net income, or
- Minimum investment return.

If a private foundation’s qualifying distributions exceed its minimum investment return for the tax year, but are less than its adjusted net income, substantially all of the total qualified distributions must be made directly for the active conduct of the foundation’s exempt activities. However, if the foundation’s minimum investment return is less than its adjusted net income and its qualified distributions equal or exceed the adjusted net income, only that part of the qualified distributions equal to substantially all of the foundation’s adjusted net income must be made directly for the active conduct of the foundation’s exempt activities. (See IRM 7.26.6.3.1)

Note: “Minimum investment return” is defined in IRC section 4942(e) and generally means 5% of the fair market value of the foundation’s assets, other than assets used (or held for use) directly in the foundation’s exempt functions, less related acquisition indebtedness. Minimum investment return is further discussed in IRM 7.27.16.

---

**Assets Test**

A private foundation will meet the assets test if 65% or more of its assets:

1. Are devoted directly to the active conduct of its exempt activity, a functionally related business, or a combination of the two,

2. Consist of stock of a corporation that is controlled by the foundation (by ownership of at least 80% of the total voting power of all classes of stock entitled to vote and at least 80% of the total shares of all other classes of stock) and at least 85% of the assets of which are so devoted, or

3. Are any combination of (1) and (2).

*Continued on next page*
Assets Test
(continued)

An asset is devoted directly to the foundation’s exempt purpose only if it is used by the foundation in actually carrying on the charitable, educational, or other similar function that gives rise to the exempt status of the foundation. Assets such as real property, physical facilities or objects (such as museum assets, classroom fixtures, and research equipment) and intangible assets (such as patents, copyrights, and trademarks) are directly devoted to the extent they are used by the foundation in directly carrying on its exempt activities or program. However, assets (for example, stock, bonds, or rental property) including endowment funds, when held primarily for the production of income, for investment, or for some similar use, are not devoted directly to the active conduct of the foundation’s exempt function, even though income from the assets is used to carry on the foundation’s exempt function. (See IRM 7.26.6.3.3)

Endowment Test

A foundation will meet the endowment test if it normally makes qualifying distributions directly for the active conduct of its exempt activities of at least two-thirds of its minimum investment return.

In determining whether the amount of qualifying distributions is at least two-thirds of the organization’s minimum investment return, the organization is not required to trace the source of the expenditures to determine whether they were received from investment income or from contributions.

Example. X Foundation, created after May 26, 1969, has $400,000 of endowment funds and other assets not directly used for its exempt purpose. X makes qualifying distributions of $20,000 during the year directly for the active conduct of its exempt function. Two-thirds of X’s minimum investment return is $13,333.33 (5% X $400,000 = $20,000; 2/3 X $20,000 = $13,333.33). Because the $20,000 distribution is greater than $13,333.33, X meets the endowment test.

In most cases, the foundation satisfies the endowment test if it satisfies the income test. Only where the minimum investment return is markedly higher than adjusted net income does the endowment test (and thus the other alternative tests as well) have independent significance. (See IRM 7.26.6.3.4)

Continued on next page
Support Test

A private foundation will meet the support test if:

1. At least 85 percent of its support (other than gross investment income) is normally received from the general public and 5 or more unrelated exempt organizations,

2. Not more than 25 percent of its support (other than gross investment income) is normally received from anyone exempt organization, and

3. Not more than 50 percent of its support is normally received from gross investment income.

Here the term support means gifts, grants, contributions, membership fees, the value of services or facilities furnished by a governmental unit without charge, net income from unrelated business activities, and gross receipts from admissions, sales of merchandise, performance of services, or providing facilities in any activity that if not an unrelated trade or business.

The support received from any one exempt organization may be counted toward satisfying the 85 percent support test only if the foundation receives support from at least five exempt organizations.

Support from the general public includes support received from an individual, trust, corporation, or governmental unit to the extent, that the total amount received from anyone individual, trust, or corporation does not exceed 1 percent of the foundation’s total support (other than gross investment income) for the period. In applying the 1 percent limit, all support received from any donor and any person related to the donor is treated as received from one person. Support received from a governmental unit is not subject to the 1 percent limit. (See IRM 7.26.6.3.5)
Private Operating Foundations, Continued

Instructor Notes

Discuss requirements for POF status consideration prior to operations.

Newly Formed Organizations

A new foundation generally will be treated as an operating foundation only if it has satisfied the income test and one of the three other tests for its first tax year of existence. If so, it will be treated as an operating foundation from the beginning of its first year. This status will continue for its second and third tax years only if it satisfies the tests by the combination method for all tax years.

There is a special provision for newly created organizations. Before the end of its first tax year, a foundation may be treated as an operating foundation if it makes a good faith determination that it is likely to meet the tests for its first year. A good faith determination may be based on an affidavit of opinion of counsel, giving enough facts about the foundation's operations and support to enable the Internal Revenue Service to determine that the requirements are likely to be met. If a foundation is treated as an operating foundation for its first year, but actually fails to qualify for the first year, it will be treated as a non-operating foundation as of the first day of its second year. However, such a foundation may establish to the satisfaction of the Service that it is likely to qualify as an operating foundation based on its second, third, and fourth tax years. If so, it will be treated as an operating foundation until the first day of a tax year in which it fails to qualify. Status as a private foundation that is not an operating foundation will continue until the organization is able to satisfy these tests by either the three-out-of-four-year method or the combination method.

Continued on next page
Private Operating Foundations, Continued

**Example**

M, an exempt organization described in IRC section 501(c)(3) was created to improve conditions in a particular urban ghetto. M receives its funds primarily from a limited number of wealthy contributors interested in helping carry out its exempt purpose. M’s program consists of making a survey of the problems of the ghetto to determine the areas in which its funds may be applied most effectively. Approximately 10% of M’s adjusted net income is used to conduct this survey. The balance of its income is used to make grants to other nonprofit organizations doing work in the ghetto in those areas M’s survey determined to have the greatest likelihood of resulting in improved conditions.

Only 10% of M’s adjusted net income may be considered as constituting qualifying distributions made directly for the active conduct of M’s exempt activities. M does not qualify as a private operating foundation.
Summary

A private foundation is an organization described in IRC section 501(c)(3) other than an organization described in IRC section 509(a)(1), (2), (3), or (4). Common characteristics of private foundations include funding from limited sources (e.g., an individual, family, or business); tightly controlled board or governing body (often the donor or family members); future revenues from investment income or additional donations from the creator; and activities consisting of distributing funds to other charitable organizations or making grants to individuals.

Generally, classification as a public charity is more desirable than PF status. Contributions to public charities are deductible to the extent of 50% of the donor’s adjusted gross income; contributions to private foundations are generally limited to 30% of the donor’s adjusted gross income. Also, the Code contains five provisions that impose two-tier excise taxes on private foundations, foundation managers, or other disqualified persons that engage in certain prohibited acts. Private foundations must file Form 990PF annually.

The term “disqualified person” (DQP) has a direct impact on the treatment and status of private foundations in several situations. It is important in determining a PF’s potential liability for many of the Chapter 42 excise taxes and is also used in determining whether or not an organization qualifies for public charity status.

A private operating foundation is a private foundation which devotes most of its earnings and uses most of its assets to directly conduct its own tax exempt purposes rather than distributing funds to grantee organization(s) or individuals. Advantages of private operating foundation status include: they are not subject to the excise tax on failure to distribute income; contributions to POFs are deductible by the donors to the extent of 50% of the donor’s adjusted gross income; and a POF may receive qualifying distributions from a private foundation if the private foundation does not control it.

A private operating foundation must meet an income test and an assets test, endowment test or support test over its normal and regular operation over a period of years. Special provisions apply to newly formed organizations.
Instructor Guide – Exercise 13A-1

1. List two typical characteristics of a private foundation.

   **Answers:** Funding from a single or limited source, donor or family members are on the board or governing body, future revenues often from investment income or additional donations from creator, often distributes funds to other charitable organization or makes grants to individuals.

2. List three public charity classifications (including Code section and general description).

   IRC sections 509(a)(1) and 170(b)(1)(A)(i), Church or a convention or association of churches
   IRC sections 509(a)(1) and 170(b)(1)(A)(ii), School
   IRC sections 509(a)(1) and 170(b)(1)(A)(iii), Hospital, cooperative hospital service organization or a medical research organization in conjunction with a hospital
   IRC section 509(a)(3) An organization supporting either one or more publicly supported organizations
   IRC section 509(a)(4), An organization organized and operated exclusively for testing for public safety
   IRC sections 509(a)(1) and 170(b)(1)(A)(iv), An organization operated for the benefit of a college or university that is owned or operated by a governmental unit (endowment funds)
   IRC sections 509(a)(1) and 170(b)(1)(A)(vi), An organization receiving a substantial part of its support in the form of contributions from publicly supported organizations, from a governmental unit, or from the general public
   IRC section 509(a)(2), An organization receiving not more than one-third of its support gross investment income and more than one-third of its support from contributions, membership fees, and from gross receipts from activities related to its exempt functions

3. Which is not considered a disqualified person as defined in IRC section 4946?

   (a) A person who contributes $6000 per year to Lee Foundation (Foundation’s income is $10,000 per year)
   (b) The founder of an organization
   (c) A for-profit corporation in which an officer owns a 20% interest
   (d) The husband or wife of a director

   **Answer:** (c) An organization in disqualified persons hold more than a 35% interest is considered a disqualified person. However, an owner of more than 20% interest of an organization that is a substantial contributor to the foundation is a disqualified person.

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Continued on next page

4. What is one of the advantages of classification as a private operating foundation rather than as a private foundation?

Answer: They are not subject to the excise tax on failure to distribute income; contributions to POFs are deductible by the donors to the extent of 50% of the donor’s adjusted gross income, whereas contributions to other private foundations are generally limited to 30% of the donor’s adjusted gross income; a POF may receive qualifying distributions from a private foundation if the private foundation does not control it.
## Chapter 13
### Lesson B

### 509(a)(1) Foundation Status

**Instructor Preparation**

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<td>Reference Materials</td>
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<td>Training Aids</td>
<td>TA 13B-1, Objectives</td>
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<td>Notes to Instructor</td>
<td>None.</td>
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Chapter 13
Lesson B

Objectives

After completing this chapter you will be able to:

• Determine which organizations should be classified under IRC Section 170(b)(a)(A)(vi)

• Compute the public support tests if the organization requests and qualifies for a definitive ruling.
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Chapter 13
Lesson B

509(a)(1) Foundation Status

Overview

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<tr>
<td>Review the difference between private foundations and public charities.</td>
</tr>
<tr>
<td>This lesson will focus on publicly supported charities described in IRC section 170(b)(1)(A)(vi).</td>
</tr>
</tbody>
</table>

Introduction

IRC section 509(a)(1) excludes from private foundation status the following types of organizations:

- 170(b)(1)(A)(i) churches
- 170(b)(1)(A)(ii) schools
- 170(b)(1)(A)(iii) hospitals
- 170(b)(1)(A)(iv) operated for benefit of college or university
- 170(b)(1)(A)(v) governmental units
- 170(b)(1)(A)(vi) publicly supported organizations

This lesson focuses on publicly-supported charities described in IRC section 170(b)(1)(A)(vi). A general rule for an organization described in IRC section 170(b)(1)(A)(vi) is that it receives a substantial part of its support from gifts, grants, contributions from the general public or from a governmental unit. IRM 7.26.3 discusses the private foundation exclusion under IRC section 509(a)(1) and 170(b)(1)(A)(vi).

Churches and schools were discussed in earlier lessons. Other classifications are discussed in future training.

Continued on next page
Objectives At the end of this lesson you will be able to:

- Determine which organizations should be classified under IRC section 170(b)(1)(A)(vi)
- Compute the public support test for an organization that has been in existence for at least five years and is being granted relief from the timely filing requirement

In This Lesson This lesson contains the following topics:

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</tbody>
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IRC Section 170(b)(1)(A)(vi)

**Definition**

Treas. Reg. 1.170A-9(f) defines 170(b)(1)(A)(vi) organizations as a “publicly supported” organization which normally receives a substantial part of its support from a governmental unit or from direct or indirect contributions from the general public.

To be “publicly supported” as described in IRC sections 509(a)(1) and 170(b)(1)(A)(vi), an organization must demonstrate that one-third or more of its total support is “normally” from governmental units, direct or indirect contributions from the general public, or a combination of these sources.

(See IRM 7.26.3)

**Determining Classification under 170(b)(1)(A)(vi)**

Generally, an organization described in IRC section 509(a)(1) and 170(b)(1)(A)(vi) is one that is primarily supported by gifts, grants, and contributions. (Organization which are primarily funded by gross receipts rather than donations are generally described under IRC section 509(a)(2) and are discussed in Lesson 13C).

In order to qualify for classification under IRC sections 509(a)(1) and 170(b)(1)(A)(vi), an organization must either demonstrate that it meets the One-Third Support Test (if in existence for at least five years with timely filing relief granted) or that it can reasonably be expected to meet the One-Third Support Test at the end of its first five years of existence.

If an organization has been in existence for at least five years and is being granted exemption under IRC section 501(c)(3) during that time period, the organization must submit information showing that it has met the one-third public support test. A support test worksheet must be completed and retained in the case file at case closing. Computation of this test is described in the following section.
Determining Classification under 170(b)(1)(A)(vi), Continued

If you determine that an organization cannot reasonably be expected to be publicly supported, this issue should be developed further. If necessary, the organization may agree to be classified as a private foundation. If the issue cannot be resolved and the organization does not agree to be classified as a private foundation, you may need to considering granting exemption under 501(c)(3), but doing an adverse determination of foundation classification. Adverse foundation classifications should be discussed with your manager.

Page 11, Form 1023

Prior to September 2008, an organization was granted either a definitive or advance ruling on its foundation classification based on its period of existence. Changes in the Regulations have eliminated the advance ruling period at the time a determination is made. However, Form 1023 has not been updated to reflect this change. Page 11 of Form 1023 includes information for advance and definitive rulings.

Unless an organization has been in existence for at least five years as described above, you should not require completion of the checkboxes under Item 6(a) or 6(b), a signature for the "Consent Fixing Period of Limitations Upon Assessment of Tax Under Section 4940 of the Internal Revenue Code," or definitive ruling information requested in Item 6(b)(i) or 6(b)(ii).
# One-Third Support Test

**Computing the One-Third Support Test**

The support test is calculated by using total support as the denominator and public support as the numerator. An electronic version of the support test is available on the NERD Drive. (See Exhibits 13B-1 and 13B-2)

The denominator of the support fraction includes the following:

- Gifts, grants, and contributions (entire amount)
- Membership fees
- Interest, dividends, etc.
- Net income from UBI
- Tax revenue levied
- Value of services or facilities
- Other income (excluding gain/loss from capital assets)

The numerator of the support fraction includes the following:

- Gifts, grants, and contributions*
- Membership fees*
- Tax revenue levied
- Value of services or facilities

* 2% Limitation: To the extent that a donor’s contribution exceeds 2% of an organization’s total support, it is not considered public support and, therefore, is excluded from the numerator of the public support fraction. The 2% limitation applies to any person or persons related to the donor in a manner described in IRC 4946(a)(1)(C) through (G) as if the contribution were made by the donor. **Example:** A husband and wife would be treated as one person for purposes of the 2% limitation.

In most cases, the 2% limitation does not apply to support from churches, other IRC section 170(b)(1)(A)(vi) organizations, or from governmental units referred to in IRC section 170(c)(1). It is also not applicable to support from other organizations which normally receive a substantial part of their support from direct or indirect contributions made by the general public. Treas. Reg. 1.170A–9(e)(9)(1) Example (1), illustrates the application of the 2% limitation principle. (See also Treas. Reg. 1.170A-9(f)(6), IRM 7.26.3.4.3, and Rev. Rul. 78-95)

*Continued on next page*
Special Rules

Membership Fees

Membership fees are fully included (subject to the 2% limitation) in the numerator and denominator of the recipient organization’s public support fraction if made for the recipient organization’s support rather than to purchase admissions, merchandise, services, or the use of facilities. If made for any of the latter purposes, it is important to determine further whether such membership fees represent amounts derived from unrelated or related business activities because the treatment accorded each varies. (See IRM 7.26.3.4.4)

Gross Receipts

If an organization is dependent for its support primarily on gross receipts from related activities, it is not considered publicly supported under IRC section 170(b)(1)(A)(vi) regardless of any other factors. (See Treas. Reg. 1.170A–9(f)(7)(ii) and IRM 7.26.3.4.5; to determine if gross receipts are from related activities see IRC section 513 and Treas. Reg. 1.513-(1)(d))

Support From Governmental Units

Generally, amounts received from governmental units are fully included in both the numerator and the denominator of the public support fraction. However, if the amount is received under governmental contract for services performed, it may be treated as gross receipts related to exempt purposes and fully excluded from both the numerator and the denominator. (See Treas. Reg. 1.170A–9(f)(8), Treas. Reg. 1.509(a)-3(g) and IRM 7.26.3.5)

Earmarked Grants From Public Charities and Governmental Units

If a donor makes an indirect contribution (one which is expressly or impliedly earmarked as being for, or for the benefit of, a particular recipient) through an organization described in IRC 170(b)(1)(A)(vi) or a governmental unit for a particular organization claiming status under IRC section 170(b)(1)(A)(vi), the contribution is subject to the 2% limitation. (Treas. Reg. 1.170A–9(f)(6)(v). (For further details, see Treas. Reg. 1.509(a)–3(j).) In other words, the substance of a transaction will always govern, and if the publicly supported organization or governmental unit is merely a conduit for amounts which have been expressly or impliedly earmarked by a donor as being for the particular organization, the contributions will be treated as having been made by the original donor and the 2% limitation will apply.

Continued on next page
One-Third Support Test, Continued

Examples

An exempt organization’s total income on Form 1023, page 9, *Statement of Revenues and Expenses*, includes the following:

- Gifts, grants, and contributions: $25,000
- Membership fees: $5,000
- Gross receipts from admissions: $7,500

The denominator of the support fraction would be $30,000 ($25,000 + $5,000). Gross receipts from admissions would be excluded.

Using the same figures as given in the example above, assume that one individual contributed $5,000. Since this amount is greater than 2% of total income ($30,000 x 2% = $600), the numerator would be calculated as follows:

- Contributions minus amounts over 2%
  - ($25,000 - $4,400) = $20,600
- Membership fees: 5,000
- Total for numerator: $25,600

Therefore, the public support fraction using this example is $25,600/$30,000. The percentage of public support is 85.33%, well above the 1/3 required. Note that when calculating an organization’s support test, financial data for five full years should be used.

Continued on next page
One-Third Support Test, Continued

10% Facts and Circumstances

If the organization does not demonstrate that it has received at least one-third or more of its support from the general public, but it does demonstrate that it has received at least ten percent of its financial support from the general public, you must consider the following facts and circumstances:

1. Does the organization plan to receive support from a representative number of people rather than from members of a single family?

2. Are the organization’s activities limited to a particular region or a specialized field, thereby limiting the sources of support?

3. Does the organization’s governing body represent the broad interest of the general public, or rather the private interests of a limited number of donors?

4. Does the organization’s governing body include persons who are public officials of their representatives, persons with expertise in its field of operations, community leaders, or persons elected by a broad-based membership?

5. Does the organization provide a facility or service directly for the benefit of the general public on a continuing basis?

6. Are the organization’s publications widely distributed to the general public?

7. Does the organization present programs, seminars, etc., to the general public with members of the general public having special knowledge in its field of operation?

8. Does the organization maintain a definitive, ongoing program to accomplish its exempt purposes?

9. Does the organization receive a significant part of its funding from a public charity or governmental agency to which the charity or agency is in some way held accountable as a condition of the grant, contract or contributions?

10. Does the organization maintain a dues-paying solicitation program designed to enroll a substantial number of persons in a community or area or in a particular profession or field of special interest?

11. Are the organization’s activities likely to appeal to persons having some broad common interest or purpose?

Continued on next page
12. Is the organization’s membership fee structure designed to make membership available to a broad cross-section of the interested public?

The higher an organization’s public support above 10%, the lesser is its burden of establishing its publicly supported nature through other factors. Facts and circumstances may be documented in the case file by completing the 10% Facts and Circumstances Test worksheet. When completing the worksheet, an explanation should be included explaining the specialist’s decision and weighing the factors indicated on the form (Exhibit 13B-3).

(See Treas. Reg. 1.170A-9(f)(3) for a detailed discussion on facts and circumstances as well as IRM 7.26.3.3. Examples are provided under Reg. 1.170(A)–9(e)(9) which illustrate whether an organization meets the 10% requirement. Example (2) illustrates an organization which fails to meet the 10% test. Example (3) illustrates an organization which meets the 10% rule.)

Unusual Grants

Treas. Reg. 1.170A-9(e)(6)(ii) provides that if an organization cannot meet the one-third public support test or the 10% public support requirement because of one or more unusually large contributions, then it may be entitled to exclude such contributions as support in computing whether it is publicly supported based on facts and circumstances. The following factors are considered most important in concluding that a particular contribution should be excluded as an unusual grant:

- The contribution will adversely affect the organization’s status as normally being publicly supported
- The contribution is unusual as to the amount relative to contributions which the recipient organization usually receives, or it is received unexpectedly, and
- The donor is a disinterested party with respect to the recipient organization in the sense that the donation is made solely because of the publicly supported nature of the organization

Additional facts and circumstances concerning the exclusion of unusual grants are contained in Treas. Reg. 1.509(a)–3(c)(4) and Rev. Proc. 81–7, 1981 C.B. 621.

Continued on next page
One-Third Support Test, Continued

If an organization is described in both IRC section 509(a)(1) and also in IRC section 509(a)(2) or 509(a)(3), the organization will be treated as described in IRC section 509(a)(1) (Treas. Reg. 1.509(a)-6). However, if an organization has indicated a classification other than 509(a)(1) on its application for exemption but otherwise qualifies for it, the organization should be contacted to ensure that the requested classification is not expressly desired by the organization.

Example: If an organization requests classification under both 170(b)(1)(A)(vi) and 509(a)(2) by checking box (i) on page 11 of Form 1023, the specialist should first determine if the organization meets the public support test under 170(b)(1)(A)(vi). If it meets the support test, the specialist will not need to calculate the tests under 509(a)(2).
Treas. Reg. 1.170A-9(e) defines 170(b)(1)(A)(vi) organizations as a “publicly supported” organization which normally receives a substantial part of its support from a governmental unit or from direct or indirect contributions from the general public. Such an organization must demonstrate by passing a public support test that one-third or more of its total support is “normally” from these sources of support or that it can reasonably be expected to meet the public support test at the end of its first five years of existence.

The support test is calculated by using total support as the denominator and public support as the numerator. The denominator of the support fraction includes the following:

- Gifts, grants, and contributions (entire amount)
- Membership fees
- Interest, dividends, etc.
- Net income from UBI
- Tax revenue levied
- Value of services or facilities
- Other income (excluding gain/loss from capital assets)

The numerator of the support fraction includes the following:

- Gifts, grants, and contributions (subject to 2% limitations)
- Membership fees (if no consideration received)
- Tax revenue levied
- Value of services or facilities

Other special rules may also apply.

Continued on next page
If the organization does not demonstrate that it has received at least one-third or more of its support from the general public, but it does demonstrate that it has received at least ten percent of its financial support from the general public, you must consider the 10% Facts and Circumstances Test in determining public charity classification.

If an organization is described in both IRC section 509(a)(1) and also in IRC section 509(a)(2) or 509(a)(3), the organization will be treated as described in IRC section 509(a)(1).
One-Third Support Test Chart

<table>
<thead>
<tr>
<th>IRC § 509(a)(1)/170(b)(1)(A)(vi)</th>
<th>Source of Support</th>
<th>Section 509(a)(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Numerator</td>
<td>Denominator</td>
<td>Numerator</td>
</tr>
<tr>
<td>Include 1</td>
<td>Include</td>
<td>Gifts, bequests and contributions from:</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>Individual, trust, corporation</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>Governmental unit</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>170(b)(1)(A)(vi) organization</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>Ordinary Grants</td>
</tr>
<tr>
<td>Exclude</td>
<td>Exclude</td>
<td>Unusual Grants (approved)</td>
</tr>
<tr>
<td>Exclude</td>
<td>Exclude</td>
<td>Membership Fees: to obtain merchandise, admissions, etc.</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>to provide support</td>
</tr>
<tr>
<td>Exclude</td>
<td>Include</td>
<td>Dividends and Interest</td>
</tr>
<tr>
<td>Exclude</td>
<td>Exclude</td>
<td>Rents: related activity</td>
</tr>
<tr>
<td>Exclude</td>
<td>Include</td>
<td>Other</td>
</tr>
<tr>
<td>Exclude</td>
<td>Exclude</td>
<td>Gross receipts from related activity: Admissions sale of merchandise, services rendered, fundraising not UBI (e.g. charitable gaming), facilities furnished, etc.</td>
</tr>
<tr>
<td>Exclude</td>
<td>Include</td>
<td>Net income from unrelated activity</td>
</tr>
<tr>
<td>IRC § 509(a)(1)/170(b)(1)(A)(vi)</td>
<td>Source of Support</td>
<td>Section 509(a)(2)</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>------------------</td>
<td>------------------</td>
</tr>
<tr>
<td>Numerator</td>
<td>Denominator</td>
<td>Numerator</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>Value of services received from Governmental units without charge</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>Governmental units under contracts or grants: for services rendered for benefit of the Government</td>
</tr>
<tr>
<td>Exclude</td>
<td>Exclude</td>
<td>for carrying out related activity</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>for direct benefit of public</td>
</tr>
<tr>
<td>Include</td>
<td>Include</td>
<td>Taxes levied for benefit of organization</td>
</tr>
<tr>
<td>Exclude</td>
<td>Exclude</td>
<td>Capital gains</td>
</tr>
<tr>
<td>Exclude</td>
<td>Exclude</td>
<td>Contributions of non-deductible services</td>
</tr>
<tr>
<td>Exclude</td>
<td>Exclude</td>
<td>Amounts borrowed</td>
</tr>
</tbody>
</table>

1 To the extent that the total amount of the contributions by any individual, trust, or corporation during the period involved does not exceed 2% of the organization’s total support for each period.

2 Does not include amounts received from disqualified persons. For purposes of this computation, IRC section 509(a)(2) and 509(a)(3) organizations may be considered disqualified persons. IRC section 509(a)(1) organizations and 170(c) governmental units are not considered disqualified persons.

3 Does not include amounts received from donor to contributing organization if donor is a substantial contributor to recipient organization.

4 To the extent that receipts from any person, governmental bureau, or governmental agency do not exceed the greater of $5,000 or 1% of the organization’s support in any taxable year.

5 Subject to 2% limitation described in footnote 1 above if contributions represent amounts that have been specifically earmarked for recipient organization.
SUPPORT TEST WORKSHEET FOR IRC 170(b)(1)(A)(vi) ORGANIZATIONS

Name of Organization: ___________________________________________________
Years Computed: ___________________________________________________

<table>
<thead>
<tr>
<th>SCHEDULE A</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Gifts, Grants and Contributions (do not include unusual grants)</td>
</tr>
<tr>
<td>2 Membership Fees Received</td>
</tr>
<tr>
<td>3 Gross Receipts from Admissions, etc. (related receipts) EXCLUDED</td>
</tr>
<tr>
<td>4 Investment Income</td>
</tr>
<tr>
<td>5 Net Income from Unrelated Business</td>
</tr>
<tr>
<td>6 Tax Revenues</td>
</tr>
<tr>
<td>7 Services/Facilities from a Governmental Unit</td>
</tr>
<tr>
<td>8 Other Income (do not include capital gains)</td>
</tr>
<tr>
<td>9 Total -- Lines 1-8 less Line 3 (denominator)</td>
</tr>
<tr>
<td>10 2% of Line 9</td>
</tr>
<tr>
<td>11 Sum of Lines 1, 2, 6, and 7</td>
</tr>
<tr>
<td>12 Enter NUMBER of Contributors in excess of Line 10 -- Listed on Schedule B</td>
</tr>
<tr>
<td>13 Total Amount Contributed on Schedule B *</td>
</tr>
<tr>
<td>14 Substantial Contributor 2% Support Allowance -- Line 10 * Line 12</td>
</tr>
<tr>
<td>15 Contributions in excess of 2% -- Line 13 less Line 14</td>
</tr>
<tr>
<td>16 Public Support -- Line 11 less Line 15 (numerator)</td>
</tr>
<tr>
<td>17 Public Support Percentage -- Line 16 / Line 9</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SCHEDULE B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Names of Contributors of more than 2% (Line 9) Total</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
<td>5</td>
</tr>
<tr>
<td>6</td>
</tr>
<tr>
<td>* Total Amount Contributed</td>
</tr>
</tbody>
</table>

TEST RESULT: _____________________
This page intentionally left blank.
<table>
<thead>
<tr>
<th>10% FACTS AND CIRCUMSTANCES TEST</th>
<th>CHECK</th>
<th>ONE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>1. Has the organization received at least 10% of its support from the public or governmental sources?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>2. Does the organization have a program to attract public support?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>a. Is the program continuous?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>b. Does it appear to be a bona fide program?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>c. Does it carry on the types of activities to attract support?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>d. Is the scope of its program reasonable in view of its charitable activities?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>3. Is the percentage of support above 25%? If below 25%:</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>a. Is a high percentage of support from a few individuals?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>b. Is a high percentage of support from investment income?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>c. If b. is yes, was the endowment contributed by:</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>1) governmental units</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>2) general public</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>3) few individuals</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>4. Is support received from governmental units or a representative number of persons?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>(Consider whether it limits its activities to a particular community)</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>5. Does the organization’s governing body represent the broad interests of the public?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>6. Does the organization provide facilities or services directly for the benefit of the general public on a continuing basis?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>7. Does the organization have public participation in its programs?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>8. Is the organization a membership organization? If so:</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>a. Are the solicitations for members aimed at a substantial number of persons?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>b. Are the rates designed to make membership available to many persons?</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>c. Are the activities likely to appeal to the broad general public?</td>
<td>YES</td>
<td>NO</td>
</tr>
</tbody>
</table>

REMARKS:
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Chapter 13
Lesson C

509(a)(2) Foundation Status

Instructor Preparation

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>6 hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference Materials</td>
<td>• Course book</td>
</tr>
<tr>
<td>Training Aids</td>
<td>TA 13C-1, Objectives</td>
</tr>
<tr>
<td>Notes to Instructor</td>
<td>None</td>
</tr>
</tbody>
</table>
Chapter 13
Lesson C
Objectives

After completing this chapter you will be able to:

- Determine when an organization is described in IRC section 509(a)(2)
- Compute the support tests under IRC section 509(a)(2)
Overview

Instructor Notes

Briefly, review the difference between private foundations and public charities. This lesson will focus on IRC section 509(a)(2).

Stress that a 509(a)(2) organization receives most of its support from exempt function revenues as compared to a 509(a)(1)/170(b)(1)(A)(vi) organization that receives most of their revenue from contributions.

Introduction

IRC section 509(a)(2) excludes from private foundation status organizations that normally receive more than one-third of their support from any combination of gifts, grants, contributions, membership fees, and receipts from related activities and not more than one-third of their support from gross investment income and unrelated business taxable income (less the taxes imposed under IRC section 511). IRM 7.26.4 discusses the private foundation exclusion under IRC section 509(a)(2)

Thus, an IRC section 509(a)(2) organization receives most of its support from exempt function revenues as compared to an IRC sections 509(a)(1) and 170(b)(1)(A)(vi) organization which is primarily funded by contributions (covered in Lesson 13B). If it qualifies under both 509(a)(1) and 509(a)(2) it will be classified as qualifying under 509(a)(1).

Continued on next page
Overview, Continued

Objectives
At the end of this lesson you will be able to:

- Determine when an organization is described in IRC section 509(a)(2)
- Compute the support tests under IRC section 509(a)(2)

In This Lesson
This lesson contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
<td>13C-1</td>
</tr>
<tr>
<td>General Rule</td>
<td>13C-3</td>
</tr>
<tr>
<td>One-Third Support Test</td>
<td>13C-6</td>
</tr>
<tr>
<td>Investment Income/UBI Percentage Test</td>
<td>13C-12</td>
</tr>
<tr>
<td>Computation of IRC 509(a)(2) Support Test</td>
<td>13C-13</td>
</tr>
<tr>
<td>Summary</td>
<td>13C-15</td>
</tr>
<tr>
<td>Exercise 13C-1</td>
<td>13C-17</td>
</tr>
<tr>
<td>Exhibit 13C-1: IRC 509(a)(1)/170(b)(1)(A)(vi) vs. 509(a)(2) Computation</td>
<td>13C-17</td>
</tr>
<tr>
<td>Exhibit 13C-2: Support Test Worksheet for IRC 509(a)(2) Organizations</td>
<td>13C-17</td>
</tr>
</tbody>
</table>
General Rule

Requirements

For an organization to be excluded from private status as an organization described in IRC section 509(a)(2), it must meet both of the following requirements:

1. Normally receive more than one-third of its support from any combination of:
   - Gifts, grants, contributions and membership fees, and
   - Gross receipts from admission fees, sales of merchandise, performance of services, or furnishing of facilities, to the extent that these activities are not an unrelated trade or business

2. Must normally receive NOT more than one-third of its support from gross investment income and certain unrelated business taxable income. (Treas. Reg. 1.509(a)-3(a)(3))

An example of a 509(a)(2) organization is a band booster club organization in which all of its income comes from yearbook sales, admissions to special band events and various fundraisers conducted by volunteers.

Other types of organizations include performing arts organizations, garden clubs, alumni associations, youth sports organizations, parent teacher associations, and other membership type organizations.

Continued on next page
### General Rule, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Discuss “reasonably expected to meet” requirements of the requested foundation classification.</th>
</tr>
</thead>
</table>

#### Required Tests

As with 509(a)(1) and 170(b)(1)(A)(vi) organizations, if an organization has completed at least five years of operations and is granted relief from the timely filing requirement, a public support test must be completed and retained in the case file. If it has not completed five years of operations, it must demonstrate that it can be reasonably expected to meet the support tests of IRC section 509(a)(2). To determine if an organization (in existence for at least five years) meets the required tests, compute the following using **actual** financial information:

- Total support
- Public support
- Gross investment income
- Unrelated Business Income (UBI)

An electronic version of the support test is available on the NERD Drive.

An organization in existence for less than five years must demonstrate that it can reasonably be expected to meet these required tests. As previously discussed, this information may be obtained from reviewing Form 1023 and its supporting documents as well as additional information requests from the organization if the information is not provided elsewhere in the application.

*Continued on next page*
General Rule, Continued

Other Considerations

As discussed in Lesson 13B, it is determined that an organization cannot reasonably be expected to be publicly supported, this issue should be developed further. If necessary, the organization may agree to be classified as a private foundation. If the issue cannot be resolved and the organization does not agree to be classified as a private foundation, the specialist may need to consider granting exemption under 501(c)(3), but doing an adverse determination of foundation classification. This should be discussed with the manager.

The specialist should not require completion of the following items on page 11 of Form 1023: checkboxes under Item 6(a) or 6(b)(i), a signature for the "Consent Fixing Period of Limitations Upon Assessment of Tax Under Section 4940 of the Internal Revenue Code." Unless an organization has been in existence for at least five years as described above or definitive ruling information should not be requested in Item 6(b)(i) or 6(b)(ii).
One-Third Support Test

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Define makeup of total support for computation purposes and explain the items of total support become the denominator in the final computation.</td>
</tr>
<tr>
<td>Review the items of income not considered support for 509(a)(2).</td>
</tr>
<tr>
<td>Refer to Exhibit 13C-1.</td>
</tr>
</tbody>
</table>

What is Included in “Total Support”? IRC section 509(d) defines total support. The denominator (total support) of the support fraction includes the following:

- Gifts, grants, and contributions
- Membership fees
- Gross receipts from related activities:
  - Admission fees
  - Sales of merchandise
  - Performance of services
  - Furnishing facilities in any activity which is not an UBI activity
- Interest, dividends, etc.
- Net income from unrelated business (whether or not regularly carried on)
- Tax revenue levied for benefit of organization
- Value of services or facilities furnished by governmental unit
- Other income (excluding gain/loss from capital assets)

*Continued on next page*
One-Third Support Test, Continued

What is Included in “Total Support”? (continued)

Total support does NOT include:

- The value of exemption from any federal, state or local tax (or similar benefit)
- Capital gains
- Loan Repayments
- Unusual grants

(See Exhibit 13C-1, IRC section 509(d) and IRM 7.26.4.2)

Instructor Notes

Explain what is considered qualifying support for 509(a)(2) and point out these items become the numerator in the final computation of support.

Qualifying Support

The numerator (qualifying support) of the support fraction includes the following:

- Gifts, grants, and contributions
- Membership fees
- Admission fees
- Sales of merchandise
- Service fees
- Value of services or facilities (only from a governmental unit)
- Other income (excluding gain/loss from capital assets)

(Treas. Reg. 1.509(a)-3(a)(2))

Continued on next page
## One-Third Support Test, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Review definition of disqualified persons from lesson 13A.</th>
</tr>
</thead>
</table>

### Disqualified Persons

Public support does not include any amounts received (contributions or gross receipts) from disqualified persons as defined in IRC section 4946 except that governmental units described in IRC 170(c)(1) and publicly supported charities described in IRC section 509(a)(1) are not considered DQPs regardless of the percentage of their contributions to the organization. (IRM 7.26.4.2.1)

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain this refers to gross receipts only.</th>
</tr>
</thead>
</table>

### $5,000/1% Limitation

IRC section 509(a)(2)(A)(ii) provides that gross receipts from related activities are included in the numerator of the one-third support test only to the extent that the amount received from any person does not exceed the greater of $5,000 or 1% of the organization’s total support in any taxable year. The limitation is applied on a year-to-year basis and is not cumulative.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain distinguishing between grants and gross receipts may affect the support test.</th>
</tr>
</thead>
</table>

*Continued on next page*
One-Third Support Test, Continued

**Grants vs. Gross Receipts**

Payments that are classified as grants are included in full in the numerator of the support fraction. If the payments are classified as gross receipts, they are included only to the extent that the amount received from any one person does not exceed the greater of $5,000 or 1% of the organization’s total support. (See Treas. Reg. 1.170A-9(f)(8)(ii), Treas. Reg. 1.509(a)-3(g), and Rev. Rul. 83-153)

Classification of funds as grants versus gross receipts is discussed below.

**Instructor Notes**

Give examples.

**Grants**

Treas. Reg. 1.509(a)-3(g)(1) provides that a payment is normally considered a grant if paid to encourage the recipient organization to carry on programs or activities in furtherance of the recipient’s exempt purposes even if the payee of the grant receives an incidental benefit. Terms and conditions may be imposed on the grant by the payor to insure that the funds will be used in a manner compatible with the payor’s programs and result in public benefit. However, the imposition of terms and conditions and the possibility of benefits resulting to the grantor will sometimes make it difficult to distinguish a grant from other amounts received as gross receipts from the carrying on of exempt activities. (See also IRM 7.26.4.2.4)

Continued on next page
One-Third Support Test, Continued

**Instructor Notes**

Give examples.

---

**Gross Receipts**

Treas. Reg. 1.509(a)–3(g)(2) states that if a payment requires the recipient organization to provide a specific service, facility, or product that serves the direct and immediate needs of the payor (rather than a direct benefit upon the general public), such payment is considered gross receipts to the payee and not a grant. Furthermore, where the specific service, facility, or product received by the payor is one that is usually provided by a profit-making organization in its normal course of business, that fact is considered evidence that the payment constitutes gross receipts.

Payments for research leading to the development of tangible products will usually be classified as gross receipts, while payments for basic research and studies carried on in physical or social sciences will generally be regarded as grants. Treas. Reg. 1.509(a)-3(g)(3) provides specific examples.

---

**Instructor Notes**

Refer back to Lesson 13B discussion

---

**Special Rules: Membership Fees**

Membership fees that represent income from related business activities, such as purchases of admission, merchandise, or services, are considered receipts from related activities. They would be included as contributions if their basic purpose is to provide support for the organization. (See IRM 7.26.4.2.5)

*Continued on next page*
**One-Third Support Test, Continued**

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain provisions are the same as those discussed in Lesson 13B.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unusual Grants</strong></td>
<td>Similar to the provisions under IRC sections 509(a)(1) and 170(b)(1)(A)(vi), Treas. Reg. 1.509(a)-3(c)(3) provides that if an organization cannot meet the one-third public support test because of one or more unusually large contributions, then it may be entitled to exclude such contributions as support in computing whether it is publicly supported based on facts and circumstances. The following factors are considered most important in concluding that a particular contribution should be excluded as an unusual grant:</td>
</tr>
<tr>
<td></td>
<td>- The contribution will adversely affect the organization’s status as normally being publicly supported</td>
</tr>
<tr>
<td></td>
<td>- The contribution is unusual as to the amount relative to contributions which the recipient organization usually receives, or it is received unexpectedly, and</td>
</tr>
<tr>
<td></td>
<td>- The donor is a disinterested party with respect to the recipient organization in the sense that the donation is made solely because of the publicly supported nature of the organization</td>
</tr>
<tr>
<td></td>
<td>Additional facts and circumstances concerning the exclusion of unusual grants are contained in Treas. Reg. 1.509(a)—3(c)(4) and Rev. Proc. 81–7, 1981 C.B. 621.</td>
</tr>
</tbody>
</table>
### Investment Income/UBI Percentage Test

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Stress that both Tests must be met:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>MORE THAN 1/3</strong> from contributions/related activities, <strong>AND</strong></td>
</tr>
<tr>
<td></td>
<td><strong>NOT MORE THAN 1/3</strong> of its total support from investment income/unrelated business income.</td>
</tr>
</tbody>
</table>

### Introduction

In addition to the one-third support test an organization must also meet the gross investment income and unrelated business income test set forth in IRC section 509(a)(2)(B). An organization will meet this test only if it normally receives **NOT MORE THAN** one-third of its total support in each taxable year from these sources. (See IRM 7.26.4.3)

### Gross Investment Income

IRC section 509(e) provides that the term “gross investment income” means the gross amounts of income from interest, dividends, payments with respect to securities loans, rents and royalties, but not including any such income if it is subject to unrelated business income tax.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Briefly review exceptions to UBI (will be covered in Unit 1b.) Volunteer labor; Donated goods; convenience of members.</th>
</tr>
</thead>
</table>

### Unrelated Business Taxable Income

Unrelated business taxable income, as defined in IRC section 512, includes gross income derived from any trade or business which is not substantially related to the exercise or performance by an organization of its exempt purpose or function constituting the basis for its exemption, with certain exceptions.
Computation of IRC 509(a)(2) Support Test

**Instructor Notes**

Stress the agent should first check to see if the organization qualifies under 509(a)(1)/170(b)(1)(A)(vi) because this is the more favorable classification.

Refer to Exhibit 13C-2 for sample support worksheet.

Have students open electronic support test to (a)(2) computation pages.

---

**Example**

An exempt organization’s total income on Form 1023, page 9, includes the following:

<table>
<thead>
<tr>
<th>Total Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions (from general public)</td>
</tr>
<tr>
<td>Contributions from disqualified persons</td>
</tr>
<tr>
<td>Gross investment income</td>
</tr>
<tr>
<td>Exempt function income from Mr. Oak*</td>
</tr>
<tr>
<td>Exempt function income from Mr. Elm</td>
</tr>
<tr>
<td>Exempt function income from general public</td>
</tr>
</tbody>
</table>

**Total Support** $ 600,000

The denominator (total support) equals $600,000.

The numerator (qualifying support) of the fraction equals $236,000. Thus the organization meets the one-third support test ($236,000 / $600,000 = 39.33%).

**Qualifying Support**

| Contributions (from general public) | $ 40,500 |
| Exempt function income from Mr. Oak* | $  6,000 |
| Exempt function income from Mr. Elm | $  5,500 |
| Exempt function income from general public | $184,000 |

**Total Support** $236,000

* limited to the greater of $5,000 or 1% of total support.

(1% * $600,000 = $6,000)

*Continued on next page*
Computation of IRC 509(a)(2) Support Test, Continued

Example (continued)  
Gross Investment income equals $120,000. Thus the organization also meets the not more than one-third from investment income/UBI percentage test ($120,000 / $600,000 = 20%). The organization is not a private foundation as it is excluded under IRC section 509(a)(2).

See Exhibit 13C-2 for a sample support test. Note that, when calculating an organization’s support test, financial data for five years should be requested from the organization.

Instructor Notes  
Class Exercise: Administer and go over answers to Class Exercise 13C-1.

Conclude the session by having students compare the differences in computing the support tests for 509(a)(1)/170(b)(1)(A)(vi) and 509(a)(2)
Summary

IRC section 509(a)(2) excludes from private foundation status organizations that normally receive more than one-third of their support from any combination of gifts, grants, contributions, membership fees, and receipts from related activities and not more than one-third of their support from gross investment income and unrelated business taxable income. Thus, an IRC section 509(a)(2) organization receives most of its support from exempt function revenues as compared to an IRC sections 509(a)(1) and 170(b)(1)(A)(vi) organization which is primarily funded by contributions.

To qualify under IRC section 509(a)(2), an organization must meet both of the following requirements:

- must normally receive more than one-third of its support from any combination of gifts, grants, contributions and membership fees, and gross receipts from admission fees, sales of merchandise, performance of services, or furnishing of facilities, to the extent that these activities are not an unrelated trade or business and
- must normally receive NOT more than one-third of its support from gross investment income and certain unrelated business taxable income.

Public support does not include any amounts received (contributions or gross receipts) from disqualified persons and gross receipts from related activities are included in the numerator of the one-third support test only to the extent that the amount received from any person does not exceed the greater of $5,000 or 1% of the organization’s total support in any taxable year.

Grants, gross receipts and membership fees should be closely reviewed to ensure proper classification in the support test. As with the 509(a)(1) and 170(b)(1)(A)(vi) support test, unusual grants should be evaluated to determine if they should be excluded from support calculations.

IRC section 509(e) provides that the term “gross investment income” means the gross amounts of income from interest, dividends, payments with respect to securities loans, rents and royalties, but not including any such income if it is subject to unrelated business income tax.
Instructor Guide – Exercise 13C-1

Using the attached worksheet to calculate an organization’s public support percentage under IRC section 509(a)(2) given the following facts:

Organization A receives:

Situation A:
- Donation of $1,000 from Church A
- Grant of $500 from Government Unit B
- Fundraising receipts of $120,000
- Investment income of $10,000
- Gross receipts of $15,000 from Unrelated Individual C

Why does the organization not qualify under 509(a)(1) and 170(b)(1)(A)(vi)?

Answer: Less than 5% of total support is from gifts, grants and contributions

Public support % under 509(a)(2) _______ 84.79% _______
Gross Investment % ________________ 7.6% __________

Situation B:
- Donation of $50,000 from Individual D
- Membership dues of $10,000 (paid for participation in events)
- Fundraising receipts of $75,000
- Investment income of $75,000

Why does the organization not qualify under 509(a)(1) and 170(b)(1)(A)(vi)?

Answer: Public support % under 170(b)(1)(A)(vi) is 2%

Public support % under 509(a)(2) _______ 40.48% _______
Gross Investment % ________________ 35.71% __________

What does this mean for the organization?

Answer: If the organization would not qualify under 509(a)(3), the organization will be classified as a private foundation.
Instructor Guide – Exercise 13C-1, cont.

Situation A  SUPPORT TEST WORKSHEET FOR IRC 509(a)(2) ORGANIZATIONS

Name organization: ____________________________________________________

Years Computed: ______________________________

<table>
<thead>
<tr>
<th>PUBLIC SUPPORT TEST</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Gifts, Grants and Contributions (do not include unusual grants)</td>
<td>1500</td>
</tr>
<tr>
<td>2 Membership Fees Received</td>
<td></td>
</tr>
<tr>
<td>3 Gross Receipts from Admissions, etc. (related receipts)</td>
<td>120000</td>
</tr>
<tr>
<td>4 Investment Income</td>
<td>10000</td>
</tr>
<tr>
<td>5 Net Income from Unrelated Business</td>
<td></td>
</tr>
<tr>
<td>6 Tax Revenues</td>
<td></td>
</tr>
<tr>
<td>7 Services/Facilities from a Governmental Unit</td>
<td></td>
</tr>
<tr>
<td>8 Other Income (do not include capital gains)</td>
<td></td>
</tr>
<tr>
<td>9 Total -- Lines 1-8 (denominator)</td>
<td>131500</td>
</tr>
<tr>
<td>10 Sum of Lines 1, 2, 3, 6, and 7</td>
<td>121500</td>
</tr>
<tr>
<td>11 Deduct: a) Income from disqualified persons</td>
<td></td>
</tr>
<tr>
<td>b) Exempt function income exceeding $5,000 or 1% of line 10, whichever is greater</td>
<td>10000</td>
</tr>
<tr>
<td>12 Public Support -- Line 10 less Line 11 (numerator)</td>
<td>111500</td>
</tr>
<tr>
<td>13 Total Support -- Line 9 (denominator)</td>
<td>131500</td>
</tr>
<tr>
<td>14 Public Support Percentage -- Line 12 / Line 13</td>
<td>84.79%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GROSS INVESTMENT INCOME TEST</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>15 Investment Income -- Line 4</td>
<td>10000</td>
</tr>
<tr>
<td>16 Unrelated Business Income -- Line 5 less Tax Paid</td>
<td></td>
</tr>
<tr>
<td>17 Total Gross Investment Income -- Sum of Lines 15 and 16 (numerator)</td>
<td>10000</td>
</tr>
<tr>
<td>18 Total Support -- Line 9 (denominator)</td>
<td>131500</td>
</tr>
<tr>
<td>19 Gross Investment Percentage -- Line 17 / Line 18</td>
<td>7.6%</td>
</tr>
</tbody>
</table>

PUBLIC SUPPORT TEST RESULT: _____Passed________

INVESTMENT INCOME TEST RESULT: _____Passed________
Instructor Guide – Exercise 13C-1, cont.

Situation B SUPPORT TEST WORKSHEET FOR IRC 509(a)(2) ORGANIZATIONS

Name of Organization: ___________________________________________________
Years Computed: ___________________________________________________

<table>
<thead>
<tr>
<th>PUBLIC SUPPORT TEST</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gifts, Grants and Contributions (do not include unusual</td>
<td>50000</td>
</tr>
<tr>
<td>grants)</td>
<td></td>
</tr>
<tr>
<td>Membership Fees Received</td>
<td>10000</td>
</tr>
<tr>
<td>Gross Receipts from Admissions, etc. (related receipts)</td>
<td>75000</td>
</tr>
<tr>
<td>Investment Income</td>
<td>75000</td>
</tr>
<tr>
<td>Net Income from Unrelated Business</td>
<td></td>
</tr>
<tr>
<td>Tax Revenues</td>
<td></td>
</tr>
<tr>
<td>Services/Facilities from a Governmental Unit</td>
<td></td>
</tr>
<tr>
<td>Other Income (do not include capital gains)</td>
<td></td>
</tr>
<tr>
<td>Total -- Lines 1-8 (denominator)</td>
<td>210000</td>
</tr>
<tr>
<td>Sum of Lines 1, 2, 3, 6, and 7</td>
<td>135000</td>
</tr>
<tr>
<td>Deduct: a) Income from disqualified persons</td>
<td>50000</td>
</tr>
<tr>
<td>b) Exempt function income exceeding $5,000 or 1% of</td>
<td></td>
</tr>
<tr>
<td>line 10, whichever is greater</td>
<td></td>
</tr>
<tr>
<td>Public Support -- Line 10 less Line 11 (numerator)</td>
<td>85000</td>
</tr>
<tr>
<td>Total Support -- Line 9 (denominator)</td>
<td>210000</td>
</tr>
<tr>
<td>Public Support Percentage -- Line 12 / Line 13</td>
<td>40.48%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GROSS INVESTMENT INCOME TEST</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Income -- Line 4</td>
<td>75000</td>
</tr>
<tr>
<td>Unrelated Business Income -- Line 5 less Tax Paid</td>
<td></td>
</tr>
<tr>
<td>Total Gross Investment Income -- Sum of Lines 15 and 16</td>
<td>75000</td>
</tr>
<tr>
<td>Total Support -- Line 9 (denominator)</td>
<td>210000</td>
</tr>
<tr>
<td>Gross Investment Percentage -- Line 17 / Line 18</td>
<td>35.71%</td>
</tr>
</tbody>
</table>

PUBLIC SUPPORT TEST RESULT: Passed
INVESTMENT INCOME TEST RESULT: Failed
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## Chapter 13
### Lesson D

### 509(a)(3) Foundation Status

### Instructor Preparation

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>3 hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference Materials</td>
<td>• Course book</td>
</tr>
<tr>
<td>Training Aids</td>
<td>TA 13B-1, Objectives</td>
</tr>
<tr>
<td>Notes to Instructor</td>
<td>None.</td>
</tr>
</tbody>
</table>
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Chapter 13
Lesson D
Objectives

After completing this chapter you will be able to:

- Describe the three types of supporting organizations
- Recognize organizations incorrectly requesting classification under IRC section 509(a)(3)
Overview

Instructor Notes

Discuss why an organization would request classification as a supporting organization.

This lesson provides an overview only as (a)(3) organizations are higher graded cases.

Introduction

Organizations described in IRC section 501(c)(3) that meet the requirements of IRC section 509(a)(3) are commonly referred to as "supporting organizations."

Supporting organizations are public charities that carry out their exempt purposes by supporting one or more other exempt organizations, usually other public charities. This category can cover many types of entities including university endowment funds and organizations that provide essential services for hospital systems.

The key feature of a supporting organization is a strong relationship with an organization it supports. The strong relationship enables the supported organization to oversee the operations of the supporting organization.

This lesson provides a brief overview of supporting organizations. The specific requirements for classification as a 509(a)(3) supporting organization are discussed in more advanced training. Additional information on IRC section 509(a)(3) classification can be found in IRM 7.20.7.

Continued on next page
Overview, Continued

Objectives

At the end of this lesson you will be able to:

- Describe the three types of supporting organizations
- Recognize organizations incorrectly requesting classification under IRC section 509(a)(3)

In This Lesson

This lesson contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
<td>13D-1</td>
</tr>
<tr>
<td>General Rule</td>
<td>13D-3</td>
</tr>
<tr>
<td>Types of 509(a)(3) Organizations</td>
<td>13D-4</td>
</tr>
<tr>
<td>Other 509(a)(3) Considerations</td>
<td>13D-6</td>
</tr>
<tr>
<td>Summary</td>
<td>13D-8</td>
</tr>
<tr>
<td>Exercise 13D-1</td>
<td>13D-9</td>
</tr>
</tbody>
</table>
### General Rule

**“Supporting Organization” Defined**

IRC section 509(a)(3) excludes from the definition of “private foundation” an organization that is:

- Organized, and, at all times thereafter, operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in IRC sections 509(a)(1) or 509(a)(2)

- Operated, supervised or controlled by or in connection with one or more organizations described in IRC sections 509(a)(1) or 509(a)(2) and

- Not controlled directly or indirectly by one or more disqualified persons (as defined in IRC section 4946) other than foundation managers and other than one or more organizations described in IRC sections 509(a)(1) and 509(a)(2).

### Instructor Notes

Explain Types I & II are Grade 11 cases and Type III is Grade 13.

### Types of Supporting Organizations

In general, supporting organizations are identified by the type of relationship they have with their supported organizations. The Pension Protection Act of 2006 (PPA) classifies supporting organizations into three types (as described in the current regulations):

- **Type I**: Operated, supervised, or controlled by one or more publicly supported organizations

- **Type II**: Supervised or controlled in connection with one or more publicly supported organizations

- **Type III**: Operated in connection with one or more publicly supported organizations.
Types of 509(a)(3) Organizations

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Briefly explain (a)(3) organizations must meet an organizational as well as operational test for (a)(3) classification – organizing documents must contain provisions limiting its purposes.</th>
</tr>
</thead>
</table>

General Requirements

A supporting organization must meet an organizational test that requires it to contain provisions in its organizing document (e.g., articles of incorporation, trust instrument, etc.) that limit its purposes to operate exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more IRC 509(a)(1) or (2) organizations.

A supporting organization must also meet an operational test that requires it to engage solely in activities that support one or more publicly supported organizations.

A supporting organization may not be controlled directly or indirectly by a disqualified person.

Type I

Operated, supervised, or controlled by

The relationship between the supported organization and the supporting organization is like a parent-subsidiary relationship. This relationship exists where a majority of the supporting organization’s officers, directors, or trustees are elected or appointed by the governing bodies, members of the governing bodies, officers acting in their official capacities, or membership of one or more supported organizations.

Type II

Supervised or controlled in connection with

In a Type II relationship, the same persons control or manage both the supporting organization and the supported organization. This brother-sister relationship insures that the supporting organization will be responsive to the needs of the supported organization.

Continued on next page
### Types of 509(a)(3) Organizations, Continued

<table>
<thead>
<tr>
<th>Type III</th>
<th>Operated in connection with</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Type III supporting organization must be operated in connection with one or more publicly supported organization. Type III organizations are further classified as either functionally integrated or not functionally integrated. A Type III supporting organization must meet a responsiveness test and an integral part test. These tests are discussed in more advanced training.</td>
<td></td>
</tr>
</tbody>
</table>
Other 509(a)(3) Considerations

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Point out the supported organization may be a 501(c)(4), (5) or (6).</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Supporting Other Than 501(c)(3) Organizations</strong></td>
<td>Under certain circumstances, a supporting organization may support exempt organizations other than those described in IRC section 501(c)(3). The supported organization must be described in IRC sections 501(c)(4), (5), or (6) and meet the same public support requirements that IRC section 509(a)(2) provides for IRC section 501(c)(3) organizations. Treas. Reg. 1.509-4(k)</td>
</tr>
<tr>
<td>Instructor Notes</td>
<td>Bona fide requests for (a)(3) classification should be discussed with your manager.</td>
</tr>
</tbody>
</table>

*Continued on next page*
**Other 509(a)(3) Considerations, Continued**

**Incorrect Request for 509(a)(3) Classification**

Many applicants who are affiliated with another organization (such as booster clubs, alumni associations, small organizations fundraising for larger charities, etc.) request classification as a supporting organization under IRC section 509(a)(3). Most of these requests are made in error without a complete understanding of 509(a)(3) requirements. Generally, these types of organizations are best described in IRC sections 509(a)(1) and 170(b)(1)(A)(vi) or 509(a)(2).

If it appears that the organization has requested this classification in error, you should call the organization to discuss alternative foundation classifications. Often they will agree to classification as a public charity under IRC section 509(a)(1) or (2).

If an organization has not requested 509(a)(3) classification in error or does not agree to classification under an alternative foundation status, see your manager for possible case upgrade and/or reassignment.

**Private Foundation Classification**

If the organization fails to meet the requirements of IRC sections 509(a)(1), (2), and (3), it must be classified as a private foundation.

**Instructor Notes**

Class Exercise: Administer and go over answers to Class Exercises 13D-1.
Summary

Organizations described in IRC section 501(c)(3) that meet the requirements of IRC section 509(a)(3) are commonly referred to as "supporting organizations."

Supporting organizations are public charities that carry out their exempt purposes by supporting one or more other exempt organizations, usually other public charities. This category can cover many types of entities including university endowment funds and organizations that provide essential services for hospital systems.

The key feature of a supporting organization is a strong relationship with an organization it supports. The strong relationship enables the supported organization to oversee the operations of the supporting organization.

There are three types of supporting organizations: Type I: operated, supervised, or controlled by one or more publicly supported organizations; Type II: Supervised or controlled in connection with one or more publicly supported organizations; and Type III: Operated in connection with one or more publicly supported organizations.

Under certain circumstances, a supporting organization may support exempt organizations other than those described in IRC section 501(c)(3). The supported organization must be described in IRC sections 501(c)(4), (5), or (6).

Many applicants who are affiliated with another organization (such as booster clubs, alumni associations, small organizations fundraising for larger charities, etc.) request classification as a supporting organization under IRC section 509(a)(3) in error. Generally, these types of organizations are best described in IRC sections 509(a)(1) and 170(b)(1)(A)(vi) or 509(a)(2).
Instructor Guide - Exercise 13D-1

Match the classifications of supporting organizations to their correct Type:

Supervised or controlled in connection with … __II__ Type I
Operated in connection with … __III__ Type II
Operated, supervised, or controlled by … __I__ Type III

A supporting organization may support exempt organizations other than those exempt under IRC section 501(c)(3).

(a) True (b) False

• Answer: True Under certain circumstances, a supporting organization may support exempt organizations other than those described in IRC section 501(c)(3). The supported organization must be described in IRC sections 501(c)(4), (5), or (6) and meet the same public support requirements that IRC section 509(a)(2) provides for IRC section 501(c)(3) organizations. Treas. Reg. 1.509-4(k)

If you are assigned a case in which an organization has not requested 509(a)(3) classification in error or does not agree to classification under an alternative foundation status, what is your next step in working the case?

Answer: Discuss the case with your manager for possible case upgrade and/or reassignment

IRS 01709
# Chapter 14

**Political, Legislative (Lobbying), and Prohibited Activities**

## Instructor Preparation

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>3 hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference Materials</td>
<td>• Course book</td>
</tr>
</tbody>
</table>
| Training Aids | • TA14-1, *Objectives*  
• Class exercise  
• Whiteboard  
• Flipchart |
| Notes to Instructor | Write objectives on whiteboard prior to class. |
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Chapter 14

Objectives

After completing this chapter you will be able to:

- Identify “political activities” and “legislative (lobbying) activities” and differentiate between the two

- Determine when an activity is educational rather than political
• Explain how much political and legislative activity is permissible for IRC section 501(c)(3) organizations and other exempt organizations

• Determine whether an organization is substantially engaged in legislative activities

• Identify the consequences of excessive legislative activities
• Define an “action organization” and explain why an actions organization does not qualify for exemption under IRC section 501(c)(3)

• Explain the provisions of IRC sections 4911 and 501(h) including the excise taxes that may be imposed on an IRC section 501(c)(3) organization

• Describe the effect of activities that are illegal or contrary to public policy on tax exempt status
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Chapter 14
Political, Legislative (Lobbying), and Prohibited Activities

Overview

This lesson is designed to help the students understand:

- the difference between political and legislative activities
- that political activities are absolutely prohibited under section 501(c)(3),
- the extent to which 501(c)(3) organizations can engage in legislative (lobbying) activities,
- the difference between “direct and indirect” lobbying,
- how to identify an “action organization,”
- that a 501(c)(3) organization may not engage in activities that are illegal or violate public policy

Introduction

IRC section 501(c)(3) organizations are expressly prohibited from engaging in political activities. This lesson discusses and defines political and legislative (lobbying) activities, differentiates between the two, and explains the extent to which IRC section 501(c)(3) and other exempt organizations may engage in them.

This lesson also discusses “action organizations” and explains why they do not qualify for exemption under IRC section 501(c)(3) but may qualify for exemption under IRC section 501(c)(4).

One of the basic charitable principles for exemption is that charitable organizations may not engage in behavior that is illegal or which violates public policy. This lesson identifies and discusses prohibited activities.

Continued on next page
Overview, Continued

| Instructor Notes | Write objectives on whiteboard prior to class (or make flip charts with TA 14-1).. |

Objectives

At the end of this lesson you will be able to:

- Identify “political activities” and “legislative (lobbying) activities” and differentiate between the two

- Determine when an activity is educational rather than political

- Explain how much political and legislative activity is permissible for IRC section 501(c)(3) organizations and other exempt organizations

- Determine whether an organization is substantially engaged in legislative activities

- Identify the consequences of excessive legislative activities

- Define an “action organization” and explain why an action organization does not qualify for exemption under IRC section 501(c)(3)

- Explain the provisions of IRC sections 4911 and 501(h) including the excise taxes that may be imposed on an IRC section 501(c)(3) organization

- Describe the effect of activities that are illegal or contrary to public policy on tax exempt status

Continued on next page
In This Lesson

This lesson contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
<td>14-1</td>
</tr>
<tr>
<td>Political Activity – Prohibited Under IRC Section 501(c)(3)</td>
<td>14-4</td>
</tr>
<tr>
<td>Political vs. Educational</td>
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<td>Legislative (Lobbying) Activities</td>
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<td>Class Exercise 14-1</td>
<td>14-29</td>
</tr>
</tbody>
</table>
Political Activity – Prohibited Under IRC Section 501(c)(3)

Under the Internal Revenue Code, all section 501(c)(3) organizations are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office. Contributions to political campaigns or public statements of position (verbal or written) made on behalf of the organization in favor of or in opposition to any candidate for public office clearly violate the prohibition against political campaign activity under section 501(c)(3). Violating this prohibition will result in denial of exemption or revocation of tax-exempt status and the imposition of certain excise taxes.

Treas. Reg. 1.501(c)(3)-1(c)(3)(iii) provides that activities that constitute participation or intervention in a political campaign include, but are not limited to:

- The publication or distribution of written or printed statements or
- The making of oral statements on behalf of or in opposition to a candidate for public office.

The following are examples of activities that constitute participation or intervention in a political campaign:

- Publishing or distributing written or printed statements or making oral statements on behalf of or in opposition to such a candidate
- Paying salaries or expenses of campaign workers
- Conducting or paying the expenses of conducting a voter-registration drive limited to the geographic area covered by the campaign. (Treas. Reg. 53.4945-3(a)(2))
Political Activity – Prohibited Under IRC Section 501(c)(3), Continued

What Activities Constitute Participation or Intervention in a Political Campaign? (continued)

IRC section 4955(d)(2) provides the following examples of "political expenditures":

- Amounts paid to a candidate for public office for speeches or other services
- Travel expenses of candidates for public office
- Expenses of conducting polls, surveys, or other studies, or preparing papers or other materials, for use by candidates for public office
- Expenses of advertising, publicity, and fundraising for candidates for public office
- Any other expense which has the primary effect of promoting public recognition, or otherwise primarily accruing to the benefit, of candidates for public office
- A determination as to whether an organization has participated or intervened in a political campaign is based upon all of the relevant facts and circumstances

Instructor Notes

Define “candidate for public office.”

Who is a Candidate for Public Office?

A candidate for public office means an individual who offers himself or herself, or is proposed by others, as a contestant for an elective public office, whether such office is national, state or local. (Treas. Reg. 1.501(c)(3)-1(c)(3)(iii))

It does not matter if the candidate is not endorsed by a political party or if the office is not contested by a political party. (Rev. Rul. 67-71, 1967-1 CB 125)
Instructor Notes

Emphasize that prohibited political activity consists of activities “in support” of a candidate for public office and “in opposition” of a candidate for public office.

Who is a Candidate for Appointive Office?

Notice 88-76, 1988-27 IRB 34, states that attempting to influence the Senate confirmation of a nominee for a federal judgeship does not constitute political activity, because the federal judgeship is an appointive office, not an elective office.

However, these expenditures would be subject to the tax imposed by IRC section 527(b) on political expenditures.

Instructor Notes

Emphasize to students that political campaign activities are absolutely prohibited under section 501(c)(3). Point out that exempt organizations under section 501(c)(4), c(5), and (c)(6) may engage in political activities as long as long engaging in political activities is not their primary purpose.

Indicators of Political Activities

A determination specialist must be alert for evidence of political activity during the determination process. Some sources for revealing political activity are shown in the table below:

Continued on next page
### Political Activity – Prohibited Under IRC Section 501(c)(3), Continued

<table>
<thead>
<tr>
<th>Source</th>
<th>Reveals...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minutes, newsletters</td>
<td>Discussion of a political figures or political event</td>
</tr>
<tr>
<td>Financial statements</td>
<td>Payments to:</td>
</tr>
<tr>
<td></td>
<td>• politicians</td>
</tr>
<tr>
<td></td>
<td>• political parties</td>
</tr>
<tr>
<td></td>
<td>• political action committees (PACs)</td>
</tr>
<tr>
<td></td>
<td>• trade associations that might support a candidate</td>
</tr>
<tr>
<td></td>
<td>• legal firms diverting funds to political trustee accounts</td>
</tr>
<tr>
<td></td>
<td>• other organizations</td>
</tr>
<tr>
<td>Agreements</td>
<td>Lending/sharing of equipment, facilities, or employees</td>
</tr>
<tr>
<td>Local newspapers</td>
<td>Announcements regarding political events sponsored by the organization</td>
</tr>
<tr>
<td>Application form and activity description</td>
<td>Evidence of political activities</td>
</tr>
</tbody>
</table>

**Additional Guidance**

In Rev. Rul. 2007-41, 2007-25 I.R.B. 1421, the Service offered 21 situations illustrating the application of facts and circumstances in determining whether an IRC section 501(c)(3) organization participated in, or intervened in, any political campaign on behalf of, or in opposition to, any candidate for public office.
Political vs. Educational

Instructor Notes

Discuss types of activities that may seem political but are actually educational including voter education activities.

Hand-out (or view online) Rev. Rul. 80-282. Have the students read the Rev. Rev. then discuss why the organization’s activities were determined to be “educational” rather than political.

Emphasize to students that “facts and circumstances” must be applied in determining if an organization is engaging in political activities that are prohibited under section 501(c)(3). Explain that Rev. Rul. 2007-41 describes 21 situations in which facts and circumstances would apply.

Hand-out (or view online) Rev. Rul. 2007-41. Have students read the Rev. Rul. then call on 5-6 students to discuss one of the 21 situations listed in the Revenue Ruling and the facts and circumstances that applied.

Introduction

While some activities and disbursements are obviously political in nature, others may seem to be political but actually are educational. For example, certain voter education activities (including presenting public forums and publishing voter education guides) conducted in a non-partisan manner do not constitute prohibited political activity. In addition, other activities intended to encourage people to participate in the electoral process, such as voter registration and get-out-the-vote drives, would not be prohibited political campaign activity if conducted in a non-partisan manner.

Although discussed here, voter education and registration activities are higher graded issues and will be reviewed more in depth in advanced training. If assigned such a case, see the manager for possible case upgrade and/or reassignment. These types of cases are also subject to mandatory review.

Voter Education

Rev. Rul. 78-248, 1978-1 CB 154, gives four situations to illustrate that certain “voter education” activities may or may not constitute prohibited political activity. The chart below summarizes these situations. (All activities were conducted by section 501(c)(3) organizations.)

Continued on next page
### Political vs. Educational, Continued

<table>
<thead>
<tr>
<th>Description of Activity</th>
<th>Type of Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepared/distributed a compilation of voting records of Members of Congress on major legislative issues.</td>
<td>Educational</td>
</tr>
<tr>
<td>Solicited the opinions of a state’s gubernatorial candidates on a wide variety of issues. These were assembled into a voter’s guide and distributed.</td>
<td>Educational</td>
</tr>
<tr>
<td>Solicited the opinions of candidates regarding only certain issues. Assembled into voter’s guide and distributed.</td>
<td>Political</td>
</tr>
<tr>
<td>Published/distributed a guide containing voting records of Members of Congress regarding only one issue.</td>
<td>Political</td>
</tr>
</tbody>
</table>

**Rev. Rul. 80-282**

Rev. Rul. 80-282, 1980-2 CB 178, held that an organization was not participating or intervening in a political campaign and qualified for exemption under IRC section 501(c)(3) as an educational organization because it:

- Monitored and reported on legislative, judicial administrative, and other governmental activities it considered to be socially important
- Published in its newsletter a summary of voting records of Members of Congress on only those issues important to the organization
- Included in the same publication a comparison of these voting records with the organization’s position

*Continued on next page*
Political vs. Educational, Continued

Rev. Rul. 80-282 (continued)

The activities were determined to be educational because:

- All incumbents’ records were included
- Candidates for re-election were not identified
- No comment was made on an individual’s overall qualifications for public office
- No statements were made to endorse or reject any incumbent as a candidate for public office
- The organization cautioned against judging an incumbent’s qualifications based on only certain selected votes
- The publication would be distributed only to the organization’s members
- No attempt was made to target the publication toward specific areas where elections were being held or to time the publication date to coincide with an election campaign

Continued on next page
Legislative (Lobbying) Activities

Instructor Notes

Explain to students that 501(c)(3) organizations may engage in legislative (lobbying) activities as long as their legislative (lobbying) activities are “not substantial.” Discuss the “substantial part test” (page I-12 of lesson).

Introduction

In general, an organization will not qualify for exemption under IRC section 501(c)(3) if a substantial part of its activities is attempting to influence legislation (commonly known as lobbying). An IRC section 501(c)(3) organization may engage in some lobbying, but too much of this activity will result in a denial of exemption or revocation of tax exempt status.

An organization will be regarded as attempting to influence legislation if it contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting or opposing legislation or if the organization advocates the adoption or rejection of legislation.

Organizations may, however, involve themselves in issues of public policy without the activity being considered as lobbying. For example, organizations may conduct educational meetings, prepare and distribute educational materials, or otherwise consider public policy issues in an educational manner without jeopardizing their tax-exempt status.

Cases involving many public policy issues are higher graded cases. If assigned a case involving public policy, discuss the case with the manager for possible case upgrade and/or reassignment.

Instructor Notes

Have student define “legislation.”

Continued on next page
Political vs. Educational, Continued

**What is Legislation?**

Legislation includes action by:

- Congress
- Any state legislature
- Any local council or similar governing body
- The public in a referendum, initiative, or similar procedure
- Indian tribal governments

Legislation does NOT include action by executive, judicial, or administrative entities unless they are developing legislation. (Treas. Reg. 1.501(c)(3)-1(c)(3)(ii))

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Have student define “direct lobbying.”</th>
</tr>
</thead>
</table>

*Continued on next page*
**Political vs. Educational, Continued**

**Definition of Direct Lobbying**

Direct lobbying is any attempt to influence any legislation through communication with:

- Any member or employee of a legislative body, or
- Any government official or employee (other than a member or employee of a legislative body) who may participate in the formulation of the legislation, but only if the principal purpose of the communication is to influence legislation. (Treas. Reg. 56.4911-2(b)(1))

- The communication must:
  - Refer to specific legislation, AND
  - Reflect a view on such legislation

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Have student define “grassroots lobbying.”</th>
</tr>
</thead>
</table>

**Definition of Grass Roots Lobbying**

According to Treas. Reg. 56.4911-2(b)(2), grass roots lobbying is any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof.

- Refer to specific legislation,
- Reflect a view on such legislation, AND
- Encourage the reader to take action with respect to such legislation

*Continued on next page*
### Instructor Notes
Discuss activities which are NOT considered to be activities “influencing legislation.”

<table>
<thead>
<tr>
<th>Activities Which Are NOT Considered To Be “Influencing Legislation”</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRC section 4911(d)(2) specifies that these activities are not lobbying, and are therefore allowable:</td>
</tr>
<tr>
<td>• Making available the results of nonpartisan analysis, study, or research</td>
</tr>
<tr>
<td>• Providing technical advice or assistance to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision</td>
</tr>
<tr>
<td>• Appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, tax exempt status, or the deduction of contributions to the organization</td>
</tr>
<tr>
<td>• Communications between the organization and its bona fide members about legislation or proposed legislation of direct interest to the organization and such members, as long as the organization does not encourage the members to individually take action</td>
</tr>
<tr>
<td>• Certain communications with members or employees of legislative bodies</td>
</tr>
</tbody>
</table>

Continued on next page
**Political vs. Educational, Continued**

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Discuss the characteristics of “action organizations.” Explain that action organizations will not qualify for exemption under section 501(c)(3) but may qualify for exemption under section 501(c)(4).</th>
</tr>
</thead>
</table>

**Action Organizations**

Action organizations are organizations whose lobbying (or political) activities are so extensive that they prevent them from being exempt under IRC section 501(c)(3). (Treas. Reg. 1.501(c)(3)-1(c)(3)(ii) and (iii)) Although an action organization cannot be exempt under IRC section 501(c)(3), it may qualify for exemption under IRC section 501(c)(4).

**Characteristics of Action Organizations**

An action organizations has two characteristics:

- Its main or primary objective is gained only by legislation or a defeat of proposed legislation, **AND**
- It advocates or campaigns for attainment of its primary objective instead of engaging in nonpartisan analysis, study or research and making those results available to the public.

All facts and circumstances should be considered when making this determination. (Treas. Reg. 1.501(c)(3)-1(c)(3)(iv))

*Continued on next page*
**Political vs. Educational, Continued**

<table>
<thead>
<tr>
<th>Substantial Part Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>As previous discussed, an organization will generally not qualify for exemption under IRC section 501(c)(3) if a substantial part of its activities is attempting to influence legislation (commonly known as lobbying). The meaning of “substantial” has always been based on facts and circumstances, with no percentage guidelines:</td>
</tr>
<tr>
<td>• <em>Seasongood v. Commissioner</em>, 227 F.2d 907, (6th Cir, 1955), held that 5% of expenditures was not substantial.</td>
</tr>
<tr>
<td>• <em>Haswell v. United States</em>, 500 F.2d 1133, (Ct Cl 1974), cert denied, 419 US 1107 (1975), held that 16.6% to 20.5% was substantial.</td>
</tr>
<tr>
<td>• <em>Christian Echoes National Ministry, Inc v. United States</em>, 470 F.2d 849 (10th Cir 1972), rejected the use of a percentage test to determine whether activities were substantial.</td>
</tr>
<tr>
<td>• GCM 36148 (January 28, 1975) stated that the use of a percentage test was not conclusive and, if one were used, then 10% would be too high.</td>
</tr>
</tbody>
</table>

Other factors to be considered in conjunction with the amount of expenditures are:

• amount of volunteer time devoted to the activity,

• amount of publicity assigned to the activity, and

• continuous or intermittent nature of the activity

The vagueness of the substantial part test led to the enactment of IRC sections 501(h) and 4911 in 1976, which together introduced the expenditure test. However, it is generally held that legislative (lobbying) expenditures that are 5% or less of an organization’s total expenditures are not substantial.
IRC Section 501(h) Election

| Instructor Notes | Explain why an organization would make a 501(h) election and who is eligible to make the election  
Hand out Form 5768  
Briefly describe the expenditure test and procedures for making/revoking an election. |

**IRC 501(h) and IRC 4911**

IRC section 501(h) permits certain eligible IRC section 501(c)(3) organizations to elect to make limited expenditures to influence legislation. An organization making the election will, however, be subject to an excise tax under IRC section 4911 if it spends more than the amounts permitted by that section. Also, the organization may lose its exempt status if its lobbying expenditures exceed the permitted amounts by more than 50% over a 4-year period.

For any tax year in which an election under section 501(h) is in effect, an electing organization must report the actual and permitted amounts of its lobbying expenditures and grass roots expenditures on its annual return.

IRC section 501(h):

- Defines the types of organizations which are eligible for the election
- Provides the rules for proper election using Form 5768, *Election/Revocation of Election by an Eligible Sec. 501(c)(3) Organization to Make Expenditures to Influence Legislation*
- Provides for revocation of exempt status if the “ceiling amount” for either type of lobbying expenditure is exceeded in each year over the four-year period

*Continued on next page*
IRC Section 501(h) Election, Continued

IRC 501(h) and IRC 4911 (continued)

- Does not provide an escape for action organizations
- Refers directly to the definitions set forth in IRC section 4911

Expenditure Test

The expenditure test under IRC section 501(h) allows electing organizations to make lobbying expenditures within specified dollar limits.

As long as the limits are not exceeded, the organization will not:

- Be considered to be engaged substantially in legislative activities
- Owe tax under IRC section 4911
- Lose its exempt status due to legislative activity

Eligible Organizations

The provisions of these sections are:

- elective
- NOT mandatory
- Available only to the following organizations described in IRC section 501(c)(3)
  - section 170(b)(1)(A)(ii) organizations
  - section 170(b)(1)(A)(iii) organizations
  - section 170(b)(1)(A)(iv) organizations
  - section 170(b)(1)(A)(vi) organizations

Continued on next page
IRC Section 501(h) Election,  Continued

Eligible Organizations (continued)

- section 509(a)(2) organizations AND
- section 509(a)(3) organizations, other than those that support organizations described in sections 501(c)(4), (5), & (6)

If elected, the organization’s lobbying activity is then subject to the expenditure test, instead of the substantial part test.

Making the Election

Filing Form 5768 makes the election. The election is effective on the first day of the taxable year in which the form is filed. This election can be made at the time an application is submitted to the Service.

Revoking the Election

Filing Form 5768 revokes the election. The revocation is effective on the first day of the first taxable year after the year in which the notice is filed.

Example

An organization files Form 5768 on May 31, 2008 requesting a revocation of its election. If the organization’s fiscal year ends on December 31, the revocation is effective on January 1, 2009.

Substantial Part Test

Organizations that do NOT elect the provisions of IRC section 501(h) remain subject to the substantial part test. A determination as to whether or not an organization is substantially engaged in legislative activity is a facts and circumstances test.

Reporting Excise Taxes Paid By 501(c)(3) Organizations

The Taxpayer Bill of Rights 2 (PL No. 104-168, 110 Stat. 1452, enacted on July 30, 1996 (Act Section 1312(a)), amends IRC section 6033(b) to require all organizations described in IRC section 501(c)(3) to report all excise taxes paid during the year under the specific Code sections, on Form 990 as shown in the table below.

Information must be reported on returns for taxable years beginning after July 30, 1996.
IRC Section 501(h) Election, Continued

<table>
<thead>
<tr>
<th>IRC Code Section</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>4911</td>
<td>Excess expenditures to influence legislation</td>
</tr>
<tr>
<td>4912</td>
<td>Disqualifying lobbying expenditures</td>
</tr>
<tr>
<td>4955</td>
<td>Political expenditures</td>
</tr>
<tr>
<td>4958</td>
<td>Excess benefit transactions</td>
</tr>
</tbody>
</table>
Legislative (Lobbying) and Political Activities of IRC 501(c)(4), (c)(5), and (c)(6) Organizations

May IRC 501(c)(4), (c)(5), or (c)(6) Organizations Engage in Legislative (Lobbying) Activities?

Organizations described in IRC sections 501(c)(4), (c)(5), and (c)(6) may engage in an unlimited amount of legislative activities (lobbying), provided that the lobbying is related to the organization’s exempt purpose.

This principle is set forth in Rev. Rul. 61-177, 1961-1 C.B. 117, which holds that a corporation organized and operated primarily for the purpose of promoting a common business interest is exempt under IRC section 501(c)(6) even though its sole activity is introducing legislation germane to such common business interest.

Rev. Rul. 61-177 notes that there is no requirement, by statute or regulations, that a business league or chamber of commerce must refrain from lobbying activities to qualify for exemption.

Rev. Rul. 61-177 applies to organizations described in IRC sections 501(c)(4) and 501(c)(5) as well. (See also Rev. Rul. 67-293, 1967-1 C.B. 185, and Rev. Rul. 71-530, 1971-2C.B. 237)

May IRC 501(c)(4), (c)(5), or (c)(6) Organizations Engage in Political Campaign Activities?

IRC sections 501(c)(4), (c)(5) and (c)(6) organizations may engage in political campaign activities on behalf of, or in opposition to, candidates for public office provided that such intervention does not constitute the organization’s primary activity.

The regulations under IRC section 501(c)(4) provide that promotion of social welfare does not include participation or intervention in political campaigns. (Treas. Reg. 1.501(c)(4)-1(a)(2)(ii))

Continued on next page
May IRC 501(c)(4), (c)(5), or (c)(6) Organizations Engage in Political Campaign Activities? (continued)

IRC sections 501(c)(4), (c)(5) and (c)(6) organizations may engage in political campaign activities on behalf of, or in opposition to, candidates for public office provided that such intervention does not constitute the organization’s primary activity.

The regulations under IRC section 501(c)(4) provide that promotion of social welfare does not include participation or intervention in political campaigns. (Treas. Reg. 1.501(c)(4)-1(a)(2)(ii))

GCM 34233 (December 3, 1969) reaches the same conclusion with respect to labor unions described in IRC section 501(c)(5) and business leagues described in IRC section 501(c)(6). The GCM contrasts support of a candidate for office with lobbying activities.

The GCM concludes that political campaign activities cannot be the primary activity of an organization described in either IRC section 501(c)(5) or (c)(6).

Additional information on rules relating to political and legislative activities of IRC section 501(c)(4), (c)(5) or (c)(6) organizations can be found in the EO 2003 CPE, Political Campaign and Lobbying Activities of IRC 501(c)(4), (c)(5), and (c)(6) Organizations.
Prohibited Activities

Instructor Notes

Explain that 501(c)(3) organizations may not engage in activities that are illegal or contrary to public policy.

Discuss Rev. Rul. 71-447 which held that an organization that did have a racially non-discriminatory policy was prohibited from exemption under section 501(c)(3)

Hand-out (or view online) Rev. Rul. 71-447.

Discuss the three-part test described in Rev. Rul. 80-278 that is used to determine whether an organization’s activities are permissible under section 501(c)(3).

Hand-out (or view online) Rev. Rul. 80-278.

Discuss anti-war protests and confrontational activities as potentially “prohibited” activities.

Hand-out Rev. Rul. 75-384 and 80-278. Contrast activities of the two organizations.

Refer students to 1994 CPE Text, Topic L, Illegality and Public Policy

Introduction


One of the basic charitable principles is that charitable organizations may not engage in behavior that is illegal or violates public policy.

Continued on next page
Prohibited Activities, Continued

Trust Law
The illegality doctrine derives from English charitable trust law, the legal foundation on which IRC section 501(c)(3) was built. Under charitable trust law, trusts violating law or public policy cannot qualify for charitable status. (Restatement Trusts (Second) section 377, Comment c (1959); IVA A. Scott, The Law of Trusts, section 377 (4th Ed. 1989)) Thus, the “illegality doctrine” encompasses illegal activity as well as activity in violation of public policy.

IRS Viewpoint
Rev. Rul. 80-278, 1980-2 CB 175, established a three-part test to determine whether an organization’s activities will be considered permissible under IRC section 501(c)(3):

• Purpose of the organization is charitable

• Activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions, and

• Activities are in furtherance of the organization’s exempt purpose and are reasonably related to the accomplishment of the purpose

Continued on next page
Prohibited Activities, Continued

Relationship with Other Issues

If an organization engages in substantial illegal activity, it usually has also run afoul of other basic principles of tax exemption, and exempt status may be denied on those grounds, independent of the illegality issues. For example, where a hospital violates the Medicare and Medicaid Anti-Fraud and Abuse statutes by giving kickbacks to staff doctors who refer patients to the hospital, it may have also violated the proscription against inurement. In other situations, issues of substantial amounts of private benefit or insufficient community benefit may preclude exemption.

Where the activity does not create inurement and the private benefit is not substantial enough to cause denial when the benefit is weighed against the community benefit, illegality may be the only remaining issue to deny exemption.

Because illegality questions often raise difficult issues of proof, administrative jurisdiction, and substantiality, any other issues present in the case should be thoroughly developed.

Importance of Substantiality

An organization with an illegal purpose will not qualify for exemption. If the organization’s purposes are legal, the substantiality of the illegal activities will determine whether the exempt status is jeopardized.

An organization will not qualify for exempt status if it engages in substantial illegal activity. Substantiality is measured both quantitatively and qualitatively.

Quantitative Test

The quantitative test focuses on the time and attention the organization gives to the illegal activity. No exempt organization may engage in a substantial amount of activity that does not further exempt purposes. (Treas. Reg. 1.501(c)(3)-1(c)) Substantial activity that does not further exempt purposes is inconsistent with exempt status, regardless of illegality.
Prohibited Activities, Continued

Qualitative Test
The qualitative test focuses on the:

- Seriousness of the illegality involved and
- Extent to which the activity can be attributed to the organization by virtue of:
  - The involvement of directors or officers, or
  - Through clear ratification of the organization governing body

The illegal activity may be so serious that even an isolated incident would outweigh the organization’s other activities and be a basis for denial or revocation, regardless of the nature and extent of its exempt activities.

Measuring Substantiality
The question of substantiality of illegal activity was considered in GCM 34631 (October 4, 1971). That memorandum concerned an association alleged to be involved with organized crime, which was said to have used force and violence to silence a newspaper opposed to the organization. The GCM states that it is insufficient to consider only the quantitative basis for determining substantiality. For example, although many violations of local pollution regulations would be necessary to disqualify an organization from exemption, only .01% of activities directed toward robbing banks would quickly disqualify an organization. This is an example of an act having a substantial non-exempt quality, while lacking substantiality of amount.

Racial Discrimination
Until 1970, the Service granted tax exempt status to private schools regardless of the schools’ racial policies. In 1970, a District Court issued a preliminary injunction prohibiting the Service from recognizing tax exempt status of private schools in Mississippi that discriminated on the basis of race. (Green v. Kennedy, 309 F Supp. 1127, appeal dism’d sub nom. Cannon v. Green, 398 US 956 (1970)) This new position was set out in Rev. Rul. 71-447, 1971-2 CB 230.

Continued on next page
Prohibited Activities

Anti-War Protests and Confrontational Activity

An organization whose primary activity is sponsoring protest demonstrations at which participants are urged to deliberately block vehicles and pedestrians, disrupt the work of government, and prevent the movement of supplies is not exempt under IRC section 501(c)(3). (Rev. Rul. 75-384, 1975-2 CB 204)

The organization’s activities violated local ordinances and constituted “breaches of public order.” Contrast this with Rev. Rul. 80-278, 1980-2 CB 175, in which the confrontations were accomplished through the courts and were clearly not illegal.

Determining When Activity Is Illegal

It is not always easy to determine whether the activity in question is actually illegal. This is especially true when the statute in question is outside of the Service’s jurisdiction. Where the activity does not violate tax laws, the Service must either rely on another governmental body’s determination of illegality or make its own determination.

Additional Resources

*Illegality and Public Policy Considerations*, 1994 CPE Text, Topic L
Summary

The Internal Revenue Code prohibits all section 501(c)(3) organizations from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office.

Activities that constitute participation or intervention in a political campaign include the publication or distribution of written or printed statements and the making of oral statements on behalf of or in opposition to a candidate for public office.

A candidate for public office is any contestant for an elective public office, whether such office is national, state or local.

Rev. Rul. 78-248 describes four situations where “voter education” activities may or may not constitute prohibited political activity.

An organization will generally not qualify for exemption under IRC section 501(c)(3) if a substantial part of its activities is attempting to influence legislation (lobbying). Organizations may, however, involve themselves in issues of public policy without the activity being considered lobbying.

The meaning of “substantial” is based on all the facts and circumstances. Generally, however, legislative (lobbying) expenditures that are 5% or less of an organization’s total expenditures are not substantial.

The expenditure test under IRC section 501(h) allows electing organizations to make lobbying expenditures within specified dollar limits. Organizations that do NOT elect the provisions of IRC section 501(h) remain subject to the substantial part test.

IRC section 4911(d)(2) describes specific activities that are not lobbying, and are therefore allowable.

An organization exempt under IRC sections 501(c)(4), (c)(5), or (c)(6) can engage in an unlimited amount of legislative activities (lobbying), provided that the lobbying is related to the organization’s exempt purpose.

All section 501(c)(3) organization are prohibited from engaging in behavior that is illegal or violates public policy.
Class Exercise 14-1

L14 - Political, Legislative (Lobbying), and Prohibited Activities

1. Which of the following would not be considered a political activity:

(a) Payments to a political candidate for speeches or other services
(b) Preparing papers or other material for us by the candidate
(c) Preparation and distribution of voting records of members of Congress on major legislative issues
(d) Expenses of advertising, publicity, and fundraising for the candidate

Answer: (c) Preparing and distributing a non-partisan compilation of voting records of Members of Congress on major legislative issues is an educational, not a political, activity. However, preparing and distributing the voting record of a particular candidate, for the purpose of supporting and/or opposing that particular candidate for public office, would constitute political activity.

2. Involvement in political activity will deny exemption for which of the following organization:

(a) 501(c)(6)
(b) 501(c)(3)
(c) 501(c)(7)
(d) 501(c)(4)

Answer: (c) Political activity is absolutely prohibited under section 501(c)(3).

3. ________________ lobbying is any attempt to influence legislation through communication with any member or employee of a legislative body, or any government official or employee who may participate in the formation of the legislation.

Answer: Direct

Continued on next page
**Class Exercise 14-1**

4. _______________________ lobbying is any attempt to influence legislation through an attempt to affect the opinions of the general public or any segment thereof.

   **Answer:** Grassroots

5. _____________________ organizations have lobbying and political activities so extensive that exemption is denied under 501(c)(3) but could qualify under 501(c)(4).

   **Answer:** Action

6. Section ____________ permits certain eligible 501(c)(3) organizations to elect to make limited expenditures to influence legislation.

   **Answer:** 501(h)

7. Section 501(c)(3) organizations that elect to make limited expenditures to influence legislation under section 501(h) complete Form ________.

   **Answer:** Form 5768
Chapter 15
Fundraising

**Instructor Preparation**

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>2 hours</th>
</tr>
</thead>
</table>
| Reference Materials | • Course book  
• Publication 4302, A Charity’s guide to Car Donations  
• Publication 4303, A Donor’s Guide to Car Donations |
| Training Aids | • TA 15-1, *Objectives*  
• Handouts |
| Notes to Instructor | None |
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Chapter 15
Objectives

After completing this chapter you will be able to:

• Define the “commensurate test” and determine when the commensurate test is met

• Identify a “feeder organization” and recognize the exemption issues associated with feeder organizations
• Identify a “professional fundraiser,” recognize the exemption issues associated with professional fundraising and recognize what actions should be taken if assigned a case involving a professional fundraiser
• Identify gaming activities, recognize the exemption issues associated with gaming activities, including bingo; and recognize what actions should be taken if assigned a case involving gaming

• Recognize and explain exemption issues associated with internet fundraising

• Recognize and explain exemption issues associated with car, truck and boat donations
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Overview

Introduction

A primary concern of most IRC section 501(c)(3) organizations is how to finance their charitable activities. In addition to soliciting and accepting gifts, grants, and donations, many organizations engage in some form of fundraising by conducting various fundraising projects. In fact, many exempt organizations list fundraising as their primary purpose. Fundraising can raise exemption issues as well as unrelated business income issues.

Many exempt organizations engage in fundraising activities to support their exempt purposes.

Fundraising activities can raise exemption issues as well as unrelated business income issues.

Motivation

It is important for students to carefully evaluate all proposed fundraising activities in order to determine if fundraising activities constitute an unrelated trade or business.

Explain to students that exemption issues arise relative to fundraising when an organization uses most of its revenue to pay fundraising and administrative expenses while using a disproportionately small amount of its fundraising revenue for its exempt activities.

Continued on next page
Overview, Continued

Objectives

At the end of this lesson you will be able to:

- Explain the “commensurate test” and determine when it is met
- Define a “feeder organization”
- Identify the exemption issues associated with feeder organizations
- Recognize the exemption issues associated with professional fundraising
- State what actions should be taken if assigned a case involving a professional fundraiser
- Recognize the exemption issues associated with gaming activities, including bingo
- State what actions should be taken if assigned a case involving gaming
- Name and explain exemption issues associated with internet fundraising
- List and explain exemption issues associated with car, truck, and boat donations

Continued on next page
Overview, Continued

This chapter contains the following topics:

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<th>Topic</th>
<th>See Page</th>
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<td>Overview</td>
<td>15-1</td>
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<td>The Commensurate Test</td>
<td>15-4</td>
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<td>Feeder Organizations - IRC Section 502</td>
<td>15-8</td>
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<td>Professional Fundraising</td>
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<td>Internet Fundraising Issues</td>
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<tr>
<td>Car, Truck, and Boat Donations</td>
<td>15-22</td>
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<tr>
<td>Summary</td>
<td>15-23</td>
</tr>
</tbody>
</table>
The Commensurate Test

Introduction

It is clearly established by law that an organization with the purpose of distributing funds to other charitable organizations recognized as exempt under IRC section 501(c)(3) may itself qualify for IRC section 501(c)(3) exemption (Rev. Rul. 67-149, 1967-1 C.B. 133).

If we determine that the fundraising activities of an organization do not constitute an unrelated trade or business and that its payments to charity are commensurate with revenue generated by fundraising, the organization will qualify for exempt status. However, issues arise when an organization uses most of its revenue to pay fundraising and administrative expenses while using a disproportionately small amount of its revenue for its exempt activities.

Instructor Notes

Explain the “commensurate test” and its origin in Rev. Rul. 64-182

Hand-out (or view online) Rev. Rul. 64-182

Rev. Rul. 64-182

The “commensurate test” was first presented in Rev. Rul. 64-182, 1964-1, C.B. 186. In this ruling, an organization derived its income principally from renting space in a commercial property that it owned and operated. It was held to be exempt under IRC section 501(c)(3) because its primary purpose was found to be raising funds for distribution for charitable purposes. The ruling states that an organization that distributes funds for charitable purposes in an amount commensurate to its resources would qualify for IRC section 501(c)(3) exemption.

Continued on next page
The Commensurate Test, Continued

Instructor Notes

Explain what factors can be considered in determining if an organization’s distributions to charity are “commensurate” with revenue generated by fundraising activities.

How Much Is Enough?

How much is enough is the key question, and it remains unanswered. The commensurate test does not lend itself to a rigid numerical distribution formula. There is no fixed percentage of income that an organization must pay out for charitable purposes. The financial resources of any organization may be affected by such factors as:

- Start-up costs
- Overhead
- Scale of operations
- Whether labor is volunteer or salaried
- Phone or postal rates

In each case, the particular facts and circumstances must be considered. A low payout percentage does not automatically mandate the conclusion that the organization under consideration has a primary purpose that is not charitable; however, distribution levels that are extremely low should automatically invite close scrutiny. An organization that raises funds for charity but consistently uses virtually all of its income for administrative expenses and salaries, with little or no distribution to charity, cannot reasonably argue that its charitable distributions are commensurate with its financial resources.

In each case, you should determine whether the failure to make real and substantial contributions for charitable purposes is due to a reasonable cause and whether the organizations has had a reasonable period of time to make real and substantial contributions to charity.

Continued on next page
The Commensurate Test, Continued

Instructor Notes

Draw the students’ attention to court cases (Make a Joyful Noise v. Commissioner, Help the Children, Inc. v. Commissioner) and PLR 9132005, describing situations where the “commensurate test” was not met.

Explain how PLR cannot be cited as law

Examples

- *Make a Joyful Noise v. Commissioner*, TCM 1989-4, detailed an exempt organization that had been conducting bingo games lost its state permit due to a change in state law. The organization began to lease its premises to other organizations and to participate in the operations of the bingo games, receiving a portion of the gross receipts. The court held that operating regularly scheduled bingo games on behalf of other exempt organizations was an unrelated trade or business. Because the organization could not demonstrate that it conducted any charitable activities, other than unfulfilled charitable objectives, the court upheld the Service’s revocation.

- *Help the Children, Inc. v. Commissioner*, 28 TC 1128 (1957), involved an organization engaged in operating bingo games. Its charitable function consisted of contributions to charitable institutions of amounts that were insubstantial (less than 1%) when compared to gross receipts from the bingo games. The court held that the organization did not qualify for exemption because it did not operate any charitable institutions and its principal activity was the profitable operation of bingo games on a commercial basis.

- PLR 9132005 (May 3, 1991) described an organization was formed to conduct research on problems of sight and hearing. The organization held bingo games to raise money. Because its actual payments to charity were minimal (approximately 1%), the Service concluded that the organization was not carrying on a charitable program reasonably commensurate with its financial resources, and revoked its exempt status.

Continued on next page
If the commensurate test is met, an organization may qualify for exempt status under IRC section 501(c)(3) even though the fundraising activity itself is not inherently charitable. However, even if an organization makes a real and substantial contribution to charity commensurate with its financial resources, a substantial private purpose may be still be found that will disqualify it from IRC section 501(c)(3) exemption.

*PLL Scholarship Fund v. Commissioner*, 82 TC 196 (1984), involved an organization which raised funds for charity by conducting bingo games in a bar owned by the organization’s directors. The Tax Court concluded that the organization could not qualify for exemption because it had the substantial private purpose of making food and beverage sales for the benefit of the bar’s owners.

**Additional Resources**

*Fundraising*, 1982 EO CPE Text, Topic L
*Update on Fundraising*, 1986 EO CPE Test, Topic G
*Charitable Fundraising*, 1989 EO CPE Text, Topic M
Feeder Organizations — IRC Section 502

Instructor Notes

Explain what constitutes a “feeder organization under IRC section 502

Introduction

A “feeder organization” operates for the primary purpose of carrying on a trade or business for profit, the income from which is turned over or “fed” to an IRC section 501(c)(3) organization.

If an organization’s principal income-producing activity is the conduct of a trade or business, and it has no significant charitable activity other than the payment of its profits over to one or more exempt organizations, it is operated for the “primary purpose” of carrying on a trade or business for profit within the meaning of IRC section 502 and will not qualify for exemption under IRC section 501(c)(3).

Exceptions

IRC section 502(b) provides that the term “trade or business” does not include:

- The receipt of rents that would be excluded from unrelated business taxable income under IRC section 512(b)(3)
- A trade or business in which substantially all labor is volunteer labor, or
- A trade or business of selling merchandise, substantially all of which has been donated to the organization

Continued on next page
Feeder Organizations — IRC Section 502, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
</table>
| Refer students to IRM 7.25.25  
Hand-out Rev. Rul 55-449 and 73-164 as examples of “feeder organizations.”  
Hand-out Rev. Rul. 64-182, 73-164, and 68-26 as examples of organizations that are not feeder organizations. |

---

Feeder Organizations – Examples

Rev. Rul. 55-449, 1955-2 C.B. 599, holds that the construction and sale of houses by an exempt charitable foundation over a period of 18 months for the sole purpose of raising funds for the support of a church constitutes an unrelated trade or business activity. Where such activity is the primary activity of the foundation, it is a feeder and not entitled to exemption.

Rev. Rul. 73-164, 1973-1 C.B. 223, states that a church-controlled commercial printing corporation whose business earnings are periodically paid to the church, but which has no other significant charitable activity, is a feeder organization and does not qualify for exemption.

In *Piety Inc. v. Commissioner*, 82 TC 193 (1984), the Tax Court held that an organization that conducts bingo games as its sole activity, and that purported to distribute its profits to recognized charities, could not qualify for IRC section 501(c)(3) exemption because it was a feeder organization described in IRC section 502. The Court also stated that an organization must directly serve some exempt purposes before exemption could be allowed.

*Continued on next page*
Feeder Organizations – IRC Section 502, Continued

**Not a Feeder Organization – Examples**

Rev. Rul. 64-182, 1964-1, C.B. 286, holds that a corporation organized exclusively for charitable purposes which derives its income principally from the rental space in a large commercial office building which it owns, maintains, and operates, and uses such income to aid other charitable organizations through contributions and grants is entitled to exemption under IRC section 501(c)(3) where it is shown to be carrying on, through such contributions and grants, a charitable program commensurate with its financial resources.

Rev. Rul. 68-26, held that an organization controlled by a church that prints and sells educational and religious material to its parochial system is not a feeder. It is providing a service to its parent.

Rev. Rul. 80-106, provided that an organization that operates a thrift shop substantially all of the work of which is performed without compensation is not a feeder. The sale of items on consignment does not result in prohibited inurement.

**Additional Resources**

IRM 7.25.25, Feeder Organizations
Feeder Organizations under IRC 502, 1983 CPE Text, Topic F
Professional Fundraising

Discuss the definition of “professional fundraising” contained in the Instructions to Form 990.

Introduction

Many legitimate professional fundraising organizations provide useful services to exempt organizations helping them organize and conduct fundraising campaigns. Professional fundraisers offer expertise and efficiency to both newly created organizations, whose officers are unfamiliar with resources and methods for obtaining funds, and to established organizations that wish to expand their support base.

The use of professional fundraisers is an area of concern when arrangements with the professional unduly benefit the professional fundraiser, who may or may not be an “insider” with respect to the organization seeking exemption, while providing minimal amounts of income for actual charitable uses.

Hand-out redesigned Form 990 and instructions.

Definition

The instructions to Form 990 define “professional fundraising services” as:

...services performed for the organization requiring the exercise of professional judgment or discretion consisting of planning, management, the preparation of materials (e.g., direct mail solicitation packages), the provision of advance and consulting regarding solicitation of contributions, and the direct solicitation of contributions.

Continued on next page
### Professional Fundraising, Continued

**Instructor Notes**
Refer to Schedule G of Form 990 - Emphasize that organizations are required to report professional fundraising expenses, revenues from special events, and revenue from gaming activities on Schedule G of revised Form 990.

---

**Schedule G, Form 990**
Schedule G of the redesigned Form 990 requires an organization to report certain amounts of professional fundraising expenses, revenues from special events, and revenue from gaming activities.

---

**Instructor Notes**
If students are assigned such a case, they should discuss it with their manager for possible upgrading/reassignment.

---

**Professional Fundraiser Cases are Grade 12**
Cases involving professional fundraisers are generally higher graded cases. If you are assigned a case that involves a professional fundraiser that is providing professional fundraising services to an exempt organization consistent with the definition in the redesigned Form 990, see your manager for possible case upgrade or reassignment.

*Continued on next page*
Professional Fundraising, Continued

**Instructor Notes**

Point out to students that there are cases when arrangements between certain organizations (PTA’s, sports booster clubs, etc.) and professional fundraisers do not raise exemption issues. See page 3-11 of lesson.

**Exception**

While cases involving professional fundraising organizations are Grade 12 on the Case Assignment Guide, there are many instances when professional fundraising arrangements do not raise exemption issues and cases remain Grade 11 cases.

For example, many PTAs, PTOs, and youth sports organizations contract with professional fundraising companies that supply items such as wrapping paper, candy, and seasonal gift items to be sold by school students. The professional fundraiser generally keeps a percentage of the sales price and has similar contracts with numerous parent-teacher and youth sports organizations in several different states. In the absence of indications of “insider” benefit or other unusual circumstances, extensive questioning regarding professional fundraising arrangements by these types of organizations is seldom essential to the determination process.
Charitable Gaming

Instructor Notes

Emphasize to students that all cases where charitable gaming is the primary activity are Grade 12 cases assigned to a reserved inventory.

If the student encounters a case where charitable gaming is the primary activity, they should discuss it with their manager for possible reassignment.

Background

Most states require that an organization be recognized by the IRS as exempt from Federal income tax before they will issue a charitable gaming license to the organization. The following is a list of exempt organizations that are most likely to engage in charitable gaming:

- IRC section 501(c)(3) - Religious, Educational, Charitable, Scientific, Literary, etc.
- IRC section 501(c)(7) - Social & Recreation Clubs
- IRC section 501(c)(8) - Fraternal Beneficiary Societies and Associations
- IRC section 501(c)(10) - Domestic Fraternal Societies and Associations
- IRC section 501(c)(19) - Veterans’ Organizations

Continued on next page
Charitable Gaming, Continued

Charitable Gaming as Primary Activity

All determination cases where charitable gaming is the primary activity are Grade 12 cases and are currently a reserved inventory category. If you are assigned a case where charitable gaming is the primary activity, see your manager for possible case upgrade and/or reassignment.

Instructor Notes

Income from regularly conducted gaming activities is treated as unrelated business income unless specific exceptions apply (volunteer labor).

Mention to students that Schedule G of redesigned Form 990 reports revenue from gaming activities.

Charitable Gaming not Primary Activity but Present

Many exempt organizations whose primary purpose is not charitable gaming conduct bingo and various forms of “instant” games and fundraisers. Instant games include scratch-offs and pull tabs, which are also known as charitable gaming tickets.

Income from regularly conducted gaming activities is treated as unrelated business income unless specific exceptions apply which are set forth below.

Continued on next page
Exception

IRC section 513(f) provides that the term “unrelated trade or business” does not include any trade or business which consists of conducting bingo games that are not normally carried out on a commercial basis and the conduct of which is not in violation of state or local law. IRC section 513(a)(1) and Treas. Reg. 1.513-1(e)(1) except from the definition of unrelated trade or business any trade or business in which “substantially all” the work is performed for the organization without compensation. The regulations do not specify a particular percentage as satisfying the “substantially all” requirements; however, the term “substantially all” is found elsewhere in the Code and has been interpreted to be 85 percent or more.

Therefore, if an exempt organization conducts bingo as a fundraiser using substantially all volunteer labor, revenue from such activity is generally not subject to unrelated business income tax. A comprehensive discussion of the “substantially all” concept as well as what constitutes “compensation” to volunteers is found in the 1982 EO CPE Text, Fundraising, Topic L.

Development questions for determining if bingo activities meet the IRC 513(f) exception follow on the next page.

Games other than bingo, such as “instant bingo” and other pull-tab games are not within the IRC section 513(f) exception; therefore, revenue from “instant” games is subject to unrelated business income tax.

Instructor Notes

Discuss bingo development questions that can help determine whether income from gaming activities is unrelated business income (page 3-14, of lesson).
Charitable Gaming, Continued

If an applicant for exemption conducts bingo as a fundraising activity, but conduct of bingo is not its primary activity, the following development questions may be used to determine if the organization’s bingo activities: 1) constitute an unrelated trade or business, or 2) meet the exceptions set forth in IRC section 513(f) or IRC 513(a)(1), and Treas. Reg. 1.513-1(e)(1).

- What percentage of your total time will you devote to bingo?
- How often will bingo games be conducted?
- What percentage of funds will be for the operation of bingo games?
- Are your bingo games administered solely with volunteer labor? If not, please explain compensation.
- Where will the bingo games take place? Who owns the bingo hall? Is the bingo hall owner on your board of directors? Are bingo games held at the hall every night under a different nonprofit organization? Is the owner of the hall on the board of directors of these other nonprofit organizations?
- An organization engaging in business activities to further exempt purposes may qualify for exemption under IRC section 501(c)(3) if a sufficient amount of money is generated for charity. Please supply the following information regarding your bingo activity for the current year so we can determine if you meet this requirement.
  - Gross income (amount taken in at door)
  - Prizes paid out
  - Rent
  - Other expenses (itemize)
  - Net income available for charity
- Please submit proposed budgets detailing the bingo operation for the next two years in the same manner requested in the previous item.

Continued on next page
Charitable Gaming, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Refer to Schedule G</th>
</tr>
</thead>
</table>

Schedule G, Form 990  
Schedule G of the redesigned Form 990 requires an organization to report certain amounts of professional fundraising expenses, revenues from special events, and revenue from gaming activities.

---

Additional Resources  
* Gaming Publication for Tax-Exempt Organizations, IRS Publication 3079  
* Gambling Activities of Exempt Organization, 1990 EO CPE Tex, Topic M  
* Update on Gaming Activities, 1996 EO CPE Text, Topic D  
* Fundraising, 1982 EO CPE Text, Topic L
## Internet Fundraising Issues

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain importance of reviewing an organization’s website (if applicable) to review the nature of its fundraising activities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Explain that valuation issues arise where internet fundraising solicits non-cash donations</td>
</tr>
<tr>
<td></td>
<td>Explain that direct sales/merchandising as a fundraising activity raises issues of possible unrelated business income</td>
</tr>
<tr>
<td></td>
<td>Discuss potential private benefit issues of an organization providing “links” to for-profit websites</td>
</tr>
<tr>
<td></td>
<td>Explain the types of internet fundraising activities that are referred to EO Technical per IRM 7.20.1.3.</td>
</tr>
<tr>
<td></td>
<td>Have students view IRM online</td>
</tr>
</tbody>
</table>

### Introduction

Fundraising on the internet is a common practice by many exempt organizations. Fundraising on the internet can be done in three ways. First, the organization can solicit contributions (cash and non-cash); second, the organization can sell items directly on the internet; and third, the organization can refer you to other organizations’ websites to make purchases (often they will provide you with a direct link).

| Instructor Notes | Have students view IRM online |

*Continued on next page*
Internet Fundraising Issues, Continued

<table>
<thead>
<tr>
<th>Website Review and Administrative Record</th>
<th>If the applicant submits a website address, the website should be reviewed. If issues are identified and developed based on the review of the website, the reviewed website pages must be part of the Administrative Record of the case. This is accomplished by informing the organization in the development letter that their website was reviewed and sending the organization (as enclosures to the development letter) screen prints of the website pages reviewed.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Non-Cash Donations</td>
<td>The solicitation of cash donations is usually not a problem. However, the solicitation of non-cash donations may require further development. The determination specialist should determine how the fair market value (FMV) of non-cash donations is determined as well as how the donated item will be used by the applicant.</td>
</tr>
<tr>
<td>Direct Sales Merchandising</td>
<td>If an organization sells items directly on the internet, the specialist should determine if the item sold is related to the organization’s exempt purpose. If not, there may be an issue of unrelated business income.</td>
</tr>
<tr>
<td>Links to Other Organizations</td>
<td>If the applicant’s website refers you to another organization’s website, with or without a direct link, the determination specialist needs to understand the relationship between the organizations and the reason for the referral. If the applicant’s website contains a direct link or referral to a for-profit organization’s website, the issue of whether the link/referral is providing advertising or other private benefit to the for-profit organization needs to be thoroughly developed. If the applicant appears to have an established relationship with a for-profit entity discuss the case with the manager for possible case upgrade and/or reassignment as cases involving for-profit related entities are higher graded cases.</td>
</tr>
</tbody>
</table>

*Continued on next page*
## Internet Fundraising Issues, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Explain that organizations accepting car, truck, and boat donations need to explain how they will value the donation according to IRS procedures. Explain that organizations accepting car, truck, and boat donations need to explain how they will value the donation according to IRS procedures.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cases Referred to EO Technical</td>
<td>Applications from organizations involved in charitable fund raising through either auctions or percentage fee arrangements with for-profit entities and whose fundraising occurs solely over the internet are referred to EO Technical per IRM 7.20.1.4.1.</td>
</tr>
<tr>
<td>Additional Resources</td>
<td><em>Tax Exempt Organizations and World Wide Web Fundraising and Advertising on the Internet, 2000 EO CPE Text, Topic I.</em></td>
</tr>
</tbody>
</table>
## Car, Truck, and Boat Donations

### Instructor Notes

Explain that organizations accepting car, truck, and boat donations need to explain how they will value the donation according to IRS procedures.


### Car, Boat, & Truck Donations

Some organizations solicit the donation of large ticket items, such as cars, trucks and boats. The donors claim the fair market value (FMV) of the donated items as a tax deductible contribution. The organization then uses or sells the donated item.

This is an area that requires careful review to ensure that the amounts claimed as a tax deductions are not inflated values.

### Car Donation Example

Organization X aggressively solicits individuals to donate their old cars. Taxpayer A donates a 1957 Chevy that has high mileage and is in extremely poor condition. Knowing that a 1957 Chevy can be a collectible (depending on the condition), Taxpayer A consults a “blue book” and claims a tax deductible contribution of $5,000. Organization X accepts the 1957 Chevy donation and sells it for scrap value at $500. The taxpayer has claimed a value well in excess of the FMV. Organization X benefits, Taxpayer A benefits, the government and taxpayers do not.

### Additional Resources

*Fund-Raising Issues – Car Donation Programs*, 2000 EO CPE Text, Topic T
*A Charity’s Guide to Car Donations*, IRS Publication 4302
*A Donor’s Guide to Car Donations*, IRS Publication 4303
Summary

An organization with the purpose of distributing funds to other charitable exempt organizations may itself qualify for IRC section 501(c)(3) exemption if its fundraising activities do not constitute an unrelated trade or business and its payments to charity are commensurate with revenue generated by fundraising.

There is no fixed percentage of income that an organization must pay out for charitable purposes – the particular facts and circumstances of each case must be considered.

An organization that meets the commensurate test may qualify for exemption under IRC section 501(c)(3) even though the fundraising activity itself is not inherently charitable.

A feeder organization’s primary purpose is carrying on a trade or business for profit and turning over (“feeding”) the income to an IRC section 501(c)(3) organization.

If you are assigned a case that involves a professional fundraiser, see your manager for possible case upgrade or reassignment. But there are instances when cases involving professional fundraising remain Grade 11 cases.

If you are assigned a case where charitable gaming is the primary activity, see your manager for possible case upgrade or reassignment.

The term “unrelated trade or business” does not include any trade or business which consists of conducting bingo games that are not normally carried out on a commercial basis and the conduct of which is not in violation of state or local law. Revenue from games other than bingo, such as “instant bingo” and other pull-tab games is subject to unrelated business income tax.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Class exercise: Students will complete class exercise 15-1 and discuss question and answers.</th>
</tr>
</thead>
</table>
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Chapter 16
Introduction to Unrelated Business Income (UBI)

Instructor Preparation

Estimated Time
2 hours

Reference Materials
• Course book

Training Aids
• TA16-1, Objectives
• Form 990-T and Instructions
• Instructor Guide Class Exercise

Notes to Instructor
None
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Chapter 16
Objectives

After completing this chapter you will be able to:

• Describe the effect unrelated business activities may have on an exempt organization

• Identify activities that are related or unrelated to an organization’s exempt purpose

• Recognize terms used in determining unrelated activities
Chapter 16

Introduction to Unrelated Business Income (UBI)

Overview

| Instructor Notes | Explain the difference between making a determination on tax-exempt status, and making a “determination” that income is subject to UBIT. The semantics are important since EO Determinations has no jurisdiction to actually collect tax on UBI.

Write down “UBI” and “UBIT” on white board. Explain these common acronyms and that they stand for “unrelated business income” and “unrelated business income tax” |

Introduction

The term “exempt from Federal income tax” means all income received by an exempt organization from carrying out an exempt purpose is not subject to income tax.

Income received by an exempt organization from activities not related to their exempt purpose may be subject to Federal income tax.

Activities related to an exempt purpose will not have an adverse affect on receiving tax-exempt status.

Activities not related to an exempt purpose of the organization could have an adverse tax effect and possibly bar an organization from receiving exemption.

For these reasons, it will be important for you to decide whether a proposed activity is related or unrelated to the organization’s exempt purpose.

Identifying activities that are related or unrelated to an organization’s exempt purpose is necessary to determine that activities of an IRC section 501(c)(3) organization are “exclusively” for an exempt purpose. For other IRC section 501(c) organizations, we must ensure that unrelated activities do not constitute the “primary” purpose of the organization.

Continued on next page
Overview, Continued

Motivation

• Applications for exemption will not always clearly show how an activity will be conducted and how that proposed activity will promote an exempt purpose.

• It may be necessary for students to secure additional information from the applicant to determine how a given activity is related to their exempt purpose and how that activity will be conducted.

Objectives

At the end of this chapter you will be able to:

• Describe the effect unrelated business activities may have on an exempt organization

• Identify activities that are related or unrelated to an organization’s exempt purpose

• Recognize terms used in determining unrelated activities

In This Chapter

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<td>Unrelated Business Taxable Income Defined</td>
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<tr>
<td>Exercise 16-1</td>
<td>16-17</td>
</tr>
</tbody>
</table>
## Code Provisions

### Applicable to Unrelated Business Activities

The following Code sections are directly applicable to an unrelated trade or business:

- Section 511 imposes a tax on unrelated business income of charitable, etc., organizations
- Section 512 defines ways unrelated business income is computed and what exceptions and modifications apply in determining correct taxable income
- Section 513 defines circumstances under which certain unrelated activities will be excluded from the definition of unrelated trade or business

Section 514 imposes a tax on rental income received from unrelated entities when the property is subject to a mortgage

### Effect of Unrelated Activities on the Determination Process

A review of a Form 1023 or 1024 will include reviewing activities of organizations to determine if the proposed activities are sufficient to meet the requirements for exemption as required by IRC section 501(c)(3) or other non-501(c)(3) sections of the Code.

It is the specialist’s responsibility to decide whether an activity is related or unrelated to the organization’s exempt purpose.

---

**Instructor Notes**

Briefly summarize the Code sections which apply to UBI.

Have the four Code citations written on whiteboard in advance.
## Trade or Business

### Instructor Notes

The first step is to determine if an activity is a trade or business.

Define “trade or business” for students

Illustrate how a trade or business can be part of the organization’s exempt activities.

After going over the section on advertising, mention that advertising income rarely produces substantial tax revenue because of various exceptions, expense allocations, etc.

### Definition of Trade or Business

Per IRC section 513(c):

- The term “trade or business” generally includes any activity carried on for the production of income from selling goods and performing services.

- The term “trade or business” can be carried on within a larger framework of other activities that may, or may not, be related to the exempt purposes of the organization.

### Examples of Trade or Business

- The operation of extensive club facilities, consisting of a restaurant, a bar, and a cocktail lounge for members and guests by an agricultural organization constitutes the carrying on of an unrelated trade or business. (Rev. Rul. 60-86, 1960-1 C.B. 198)

- Income from the publication and sale of a book on a topic unrelated to the organization’s exempt purpose is unrelated business income. (Rev. Rul. 69-430, 1969-2 C.B. 129)

- The income derived by an exempt organization, operated for the prevention of cruelty to animals, from providing pet boarding and grooming services for the general public is income from unrelated trade or business. (Rev. Rul. 73-587, 1973-2 C.B. 192)
Trade or Business, Continued

Advertising

Another common area is the sale of advertising in publications of newsletters, journals or periodicals that contain editorial content that are distributed to members and the general public.

The publication and dissemination of the editorial content contributes importantly to the organization’s exempt purpose.

The sale of the advertising in the publications is a trade or business activity that is not related to their exempt purpose.

Additional information on classifying paid advertising can be found in the 2002 CPE Text, *UBIT: Current Developments.*
Unrelated Business Taxable Income Defined

Treas. Reg. 1.513-1(a) states that:

…unless one of the specific exceptions of section 512 or 513 is applicable, gross income of an exempt organization …is includible in the computation of unrelated business taxable income if: (1) It is income from trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Instructor Notes

Once an activity is identified as a trade or business, the next criteria to be determined is whether the activity is regularly carried on.

Define the term “regularly carried on.” Illustrate with example from text (sandwich stand).

Another good example is a high school car wash. Activity ordinarily carried on for profit – yes. Unrelated to exempt purposes – yes. However, activity not regularly carried on (one weekend in the summer, for example).

Regularly Carried On

Treas. Reg. 1.513-1(c)(2) clarifies the term “regularly carried on” as an activity which is conducted with a frequency and continuity which would be similar to commercial activities pursued by a nonexempt organization.

Examples

The operation of a sandwich stand at a state fair by a hospital auxiliary for 2 weeks during the year would not be the regular conduct of a trade or business because it would not compete with similar commercial businesses on a year round basis.

The operation of a commercial parking lot by an exempt organization every Saturday, year round, would be the regular conduct of a trade or business.

Continued on next page
### Unrelated Business Taxable Income Defined, Continued

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Define the term “substantially related” to show that the business activity must contribute importantly to accomplish the organization’s exempt purpose to be excluded from UBI.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Substantially related – rental income for low-income housing is related to exempt purposes, but rental income from operation of a commercial parking lot is not.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Substantially Related</th>
<th>The term “substantially related” requires an examination of how a business activity that generates the income helps an organization accomplish its exempt purpose. Treas. Reg. 1.513-1(d) states that to be substantially related:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• The conduct of the business activity must have a causal relationship to the achievement of exempt purposes.</td>
</tr>
<tr>
<td></td>
<td>• The conduct of the business activity must <strong>contribute importantly</strong> to the accomplishment of the organization’s exempt purposes to be substantially related. (See also IRC section 513(a))</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>An activity must “contribute importantly” to an exempt purpose, based on facts and circumstances, in order to be considered a related activity</th>
</tr>
</thead>
</table>

| Contribute Importantly | To “contribute importantly” you will need to consider how the size and the extent of the activities relate to the nature and extent of the exempt function they intend to serve. |
Specific Exclusions from Unrelated Trade or Business

Instructor Notes

Point out the exceptions of IRC section 513(a) and tell the students if the organization conducts activities with volunteer labor, for the convenience of members, or sells contributed items, the activity will not be considered unrelated to the exempt purpose.

Review each example from the lesson illustrating the three exclusions (volunteer labor, convenience of members, and donated merchandise).

Have the three exclusions from the lesson written on whiteboard in advance.

General

IRC section 513(a) provides for specific exclusions when a trade or business will not be considered an unrelated business activity.

These exclusions are:

- Trade or business activities conducted by volunteer labor
- Trade or business conducted for the convenience of members
- Trade or business involving selling merchandise received by the organization through gift or contribution

Volunteer Labor Example

An orphanage that operates a retail store where substantially all the work in carrying on the business is performed for the organization by unpaid volunteers would not be carrying on an unrelated trade or business. (Treas. Reg. 1.513-1(e))

Continued on next page
## Specific Exclusions from Unrelated Trade or Business, Continued

<table>
<thead>
<tr>
<th>Convenience of Members Example</th>
<th>A gift shop operated by the hospital for the convenience of its patients, visitors and employees is not an unrelated trade or business. (Rev. Rul. 69-267, 1969-1 C.B. 160)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The operation of a dining room, cafeteria, and snack bar by an exempt art museum for the convenience of its staff, employees and members of the public visiting the museum does not constitute an unrelated trade or business activity. (Rev. Rul. 74-399, 1974-2 C.B. 172)</td>
</tr>
<tr>
<td>Donated Merchandise Example</td>
<td>The operation of a thrift shop by an IRC section 501(c)(3) organization which sells donated books and clothing to the general public would not be considered the conduct of an unrelated trade or business. (Rev. Rul. 71-581, 1971-2 C.B. 236)</td>
</tr>
</tbody>
</table>
# Other Exclusions from Unrelated Trade or Business

## Instructor Notes

| Instructor Notes | Explain that investment income such as dividends and interest are excluded in computing UBI  
|                  | State that this exclusion does not apply to debt-financed property.  
|                  | Explain that this can require very involved computations outside the scope of this lesson, but highlight the three IRM citations from the lesson for further reference. |

## Dividends, Interest, etc.

All dividends, interest, annuities, payments with respect to securities loans, and other passive income from an exempt organization’s ordinary and routine investments are excluded in computing unrelated business taxable income.

A significant exception applies to social clubs exempt under IRC section 501(c)(7). These passive sources of income are taxable to a social club. Unit 1b will offer a detailed discussion of the unrelated business income tax provisions for these types of organizations.

## Instructor Notes

| Instructor Notes | As with dividends and interest, rent from real property is taxable to a social club.  
|                  | Explain that this can require very involved computations outside the scope of this lesson, but highlight the three IRM citations from the lesson for further reference. |

*Continued on next page*
State that this exclusion does not apply to debt-financed property. Continued

**Rental Income**

Rents from real property are also excluded in computing unrelated business taxable income. However, rents from personal property are not excluded. Also not excluded are rents from real property collected by social clubs exempt under IRC section 501(c)(7). (Social clubs are discussed in depth in Unit 1b.)

However, this exclusion does not apply to unrelated income from *debt-financed* property as imposed by IRC section 514. The amount of income included is proportionate to the debt on the property.

There are many exceptions and exclusions in this area that are too involved for an introductory lesson, but the following IRM sections are useful references to consult:

- IRM 7.27.8 – *Unrelated Debt-Financed Income*
- IRM 7.27.9 – *Debt-Financed Property*
- IRM 7.27.10 – *Acquisition Indebtedness*
## Instructor Notes

This portion of the lesson can be used to allow the students to review the Form 990-T and any instructions the instructor determines are most important for them to know.

Instructor may wish to have students pull up Form 990-T from the irs.gov website, or else pass out a hard copy.

Discuss the special schedules on the Form 990-T that give the formulas for computing items such as advertising and debt-financed property.

Stress that many students overestimate the impact of UBI. Organizations reporting UBI tend to pay little tax because they are permitted to use a reasonable expense allocation method on Form.

Instructor may have students look up the instructions for Form 1120 on the irs.gov website to view the current corporate tax rates.

## Form 990-T

A tax exempt organization which has income from an unrelated business activity is required to file a Form 990-T, *Exempt Organization Business Income Tax Return*.

This return is filed separately from the Form 990.

The organization is required to file this return only if it has $1,000 or more in gross receipts from an unrelated business activity. The Code provides for a specific deduction of the first $1,000 of gross receipts from an unrelated business activity. This specific deduction is in addition to any expenses incurred to produce the unrelated business income. Thus, even if there were no related expenses, there would never be a tax liability if the gross receipts from the unrelated business activity were below $1,000.

*Continued on next page*
Even if an organization is specifically excluded from filing a Form 990 or 990-EZ, they must file Form 990-T if they have gross receipts of $1,000 or more from an unrelated business activity. For example, a church is excluded from filing Form 990, but is still liable for filing Form 990-T if its gross receipts from an unrelated business activity are $1,000 or more.

The due date for filing this return is the same as a Form 990 which is the 15th day of the fifth month following the close of their tax year.

The unrelated income tax rates payable by most tax-exempt organizations are the corporate rates as reported on Form 1120. Refer to the Instructions for Form 1120 for the applicable tax year for the most current Tax Rate Schedule.

A Form 990-T filed by an organization exempt under IRC section 501(c)(3) after August 17, 2006, is open for public inspection. Refer to Notice 2008-49.
### Instructor Notes

Instructor may wish to have hard copies of Pub. 598 on hand, as students would benefit from keeping them at their desk for future reference.

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### Pub. 598

For more information concerning unrelated business income, refer to Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*.

This Service publication offers additional examples and a more detailed discussion of the concepts introduced in this lesson.
Summary

An organization engaging in activities not related to its exempt purpose could have an adverse tax effect and possibly bar the organization from receiving exempt status.

It is the specialist’s responsibility to determine whether an activity related or unrelated to the organization’s exempt purpose.

IRC sections 511, 512, 513, and 514 are directly applicable to unrelated trade or business activities, but do not define “unrelated business taxable income”.

Treas. Reg. 1.513-1(a) states that unrelated business income is income:

- from a trade or business
- which is regularly carried
- the conduct of which is not substantially related to an organization’s performance of its exempt functions

IRC section 513(a) provides three specific exclusions for when a trade or business is not considered unrelated business activity. These exclusions are for when a trade or business is:

- conducted by volunteer labor
- conducted for the convenience of its members
- selling merchandise received through gift or contribution

Instructor Notes

Class Exercise - Have students complete the class exercise at the end of the lesson and lead a class discussion on the questions and answers.

Administer and go over answers to Class Exercise 16-1.
1. Which of the following Code sections imposes a tax on the unrelated trade or business income of a tax-exempt organization?

(a) IRC section 511  
(b) IRC section 512  
(c) IRC section 513  
(d) IRC section 514

**Answer:** All of the above.

2. The regular sale of advertising in publications of newsletters, journals, or periodicals that contain editorial content that are distributed to members and the general public is a trade or business?

(a) True  
(b) False

**Answer:** (a), True. While the publication and dissemination of editorial content contributes importantly to the organization’s exempt purpose, the regular sale of advertising in the publications is a trade or business activity that is not related to their exempt purpose.

3. Which of the following would be an activity not specifically excluded from the definition of an unrelated trade or business?

(a) A trade or business activity conducted by volunteer labor  
(b) A trade or business conducted for the convenience of members  
(c) Income from the publication and sale of a book on a topic unrelated to the organization’s exempt purpose  
(d) A trade or business involving selling merchandise received by the organization through gift or contribution

**Answer:** (c) Income from the publication and sale of a book on a topic unrelated to the organization’s exempt purpose is unrelated business income. Refer to Rev. Rul. 69-430.
4. The Code provides for a specific exclusion of what amount before an exempt organization is liable for the filing of a Form 990-T?

(a) $3,000  
(b) $1,500  
(c) $1,000  
(d) $2,000

Answer: (c)
# Chapter 17
## Case Closing

### Instructor Preparation

<table>
<thead>
<tr>
<th>Estimated Time</th>
<th>2 hours</th>
</tr>
</thead>
</table>

### Reference Materials
- Exhibit 17-1, Form 3198-A
- Exhibit 17-2, Form 2363-A
- Exhibit 17-3, Form 2363
- Exhibit 17-4, Form 3778
- Exhibit 17-5, Denial Checklist
- Exhibit 17-6, Adverse Determination Letter
- Exhibit 17-7, Form 6038
- Exhibit 17-8, Form 14261 Memorandum to File
- Exhibit 17-9, Form 14285 - Letter 947
- Exhibit 17-10, Form 14286 - Letter 948
- Exhibit 17-11, Form 14287 - Letter 1075
- Exhibit 17-12, Form 14288 - Letter 1076
- Exhibit 17-13, Form 14289 - Letters 4587, 1314

### Training Aids
- TA17-1, *Objectives*

### Notes to Instructor
Prepare a flipchart or PowerPoint slide for the objectives.
Chapter 17
Objectives

After completing this chapter, you will be able to:

• Identify common case closing forms.

• Use the correct procedures for the more common types of closings.

• Complete Form 6038.

• Identify and prepare the correct determination letter.

• Complete closing documentation.
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Lesson 17
Case Closing

Overview

Introduction
When the specialist closes a case, it is important that certain procedures are followed. This ensures that the:

- Case file can be reviewed (by the manager or another reviewer) in a logical and expedient manner.
- Correct information is entered in the EO/Business Master File.
- Organization receives its determination (or other communication).
- Case file is routed to the appropriate personnel for further processing.

This lesson explains the common types of case closings.

Instructor Notes
- Emphasize the importance of following standard procedures.
- Display and review the Objectives on the flip chart or using the PowerPoint slide.

Objectives
At the end of this lesson you will be able to:

- Identify common case closing forms.
- Use the correct procedures for the more common types of closings.
  - Suspense
  - Withdrawal
  - Transfer to EO Technical
  - Correction Disposal
  - Proposed Adverse
- Complete Form 6038.
- Identify and prepare the correct determination letter.
- Complete closing documentation.

Continued on next page
Overview, Continued

Reference Materials
- Exhibit 17-1, Form 3198-A
- Exhibit 17-2, Form 2363-A
- Exhibit 17-3, Form 2363
- Exhibit 17-4, Form 3778
- Exhibit 17-5, Denial Checklist
- Exhibit 17-6, Adverse Determination Letter
- Exhibit 17-7, Form 6038
- Exhibit 17-8, Form 14261 Memorandum to File
- Exhibit 17-9, Form 14285 - Letter 947
- Exhibit 17-10, Form 14286 - Letter 948
- Exhibit 17-11, Form 14287 - Letter 1075
- Exhibit 17-12, Form 14288 - Letter 1076
- Exhibit 17-13, Form 14289 - Letters 4587, 1314
- IRM 7.20.2.5

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<td>Common Case Closing Forms</td>
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<tr>
<td>Suspense</td>
<td>6</td>
</tr>
<tr>
<td>Withdrawal</td>
<td>8</td>
</tr>
<tr>
<td>Cases Transferred to EO Technical</td>
<td>10</td>
</tr>
<tr>
<td>Correction Disposal</td>
<td>12</td>
</tr>
<tr>
<td>Adverse Determinations</td>
<td>13</td>
</tr>
<tr>
<td>Form 6038, EO Determination Case Checksheet</td>
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</tr>
<tr>
<td>Closing Letters</td>
<td>20</td>
</tr>
<tr>
<td>Closing Document</td>
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<tr>
<td>Summary</td>
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</table>

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### Overview, Continued

<table>
<thead>
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<th>Topic</th>
<th>See Page</th>
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</thead>
<tbody>
<tr>
<td>Exhibit 17-1: Form 3198-A</td>
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</tr>
<tr>
<td>Exhibit 17-2: Form 2363-A</td>
<td>33</td>
</tr>
<tr>
<td>Exhibit 17-3: Form 2363</td>
<td>35</td>
</tr>
<tr>
<td>Exhibit 17-4: Form 3778</td>
<td>37</td>
</tr>
<tr>
<td>Exhibit 17-5: Denial Checklist</td>
<td>39</td>
</tr>
<tr>
<td>Exhibit 17-6: Adverse Letter 4036</td>
<td>41</td>
</tr>
<tr>
<td>Exhibit 17-7: Form 6038</td>
<td>45</td>
</tr>
<tr>
<td>Exhibit 17-8: Form 14261 Memorandum to File</td>
<td>47</td>
</tr>
<tr>
<td>Exhibit 17-9, Form 14285 - Letter 947</td>
<td>49</td>
</tr>
<tr>
<td>Exhibit 17-10, Form 14286 - Letter 948</td>
<td>51</td>
</tr>
<tr>
<td>Exhibit 17-11, Form 14287 - Letter 1075</td>
<td>53</td>
</tr>
<tr>
<td>Exhibit 17-12, Form 14288 - Letter 1076</td>
<td>55</td>
</tr>
<tr>
<td>Exhibit 17-13, Form 14289 – Letters 4587, 1314</td>
<td>57</td>
</tr>
</tbody>
</table>
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Common Case Closing Forms

There are several different forms and or worksheets that are required when closing a case. Some of these forms are specific to the type of case being closed; some forms are specific to the type of closure. Some forms are used for multiple types of cases or closures.

Forms required for specific types of case closures are detailed within the appropriate sections of this lesson.

Here is a brief overview of forms that are common to many types of cases and case closures:

**Form 3198-A**

Form 3198-A (Exhibit 17-1) is used to notify the manager and administrative personnel that information in a case file must be sent to a different area or that a case requires special action at closing. The specialist completes the information fields and checks the appropriate box or enters the necessary instructions on the form. If required, this form is always stapled on the top of the front cover of the case file.

**Form 2363-A**

Form 2363-A (Exhibit 17-2) is used to enter manual updates to EO Master File when information will not be entered into EDS for an automatic update. Form 2363-A may be used to complete name or address changes, update or correct exemption information, or update the status of an organization.

**Form 2363**

Form 2363 (Exhibit 17-3) is a shorter version of Form 2363-A. It is used primarily to update an organization’s name, address and/or filing requirements.

**Instructor Notes**

- Give examples of when these forms might be used.
- Emphasize use of 3198-A when items require special handling or items need to go to other places. Give examples.
- See also IRM 7.20.2.5 for other common forms.
- Exhibits 17-1, 17-2, 17-3
**Suspense**

**Introduction**

When a written request for additional information has been made and the applicant is not providing the necessary information, the case may be closed as Suspense. Prior to closing a case Suspense, the specialist will make every reasonable attempt to secure the information. Suspense procedures only apply to I cases.

**Instructor Notes**

- Remind students that a Suspense is not an extension. A closed Suspense case, is in fact a closed case.
- Discuss pre-closing procedures: 35 day minimum, phone contact (attempts), documentation.

**Before Closing the Case as “Suspense”**

As discussed in Lesson 7, *Introduction to Case Development and Documentation*, the following steps must be followed before closing a case Suspense:

A written request for additional information must be made. The specialist will give the applicant 21 days to respond.

At the end of 21 days if a response has not been received, the specialist calls the organization to inquire about the status of the response. The specialist documents the results of the conversation on the CCR.

If the specialist reaches the organization by phone and the applicant needs additional time to respond, an extension of up to 14 days may be granted. If the specialist is not able to speak to the applicant’s representative, then a 14-day follow-up letter will be sent. The applicant is advised that if they do not provide the information in a timely manner, their case will be closed as Suspense.

If the applicant does not respond at the end of 35 days, another call is made to the organization to inquire about the status of the response. If the applicant needs additional time to respond, additional extensions may be given up based on the information requested.

If the applicant does not respond at the end of the extended period, another call will be made to the applicant to advise them that their case is being closed. Document the call on the CCR.
**Suspense, Continued**

**Instructor Notes**
- Review closing chart in text to discuss closing procedures.
- Explain when to put an addendum on the Suspense letter.

**Procedures for Closing a Case as Suspense**

Use the following chart to close a case as Suspense:

<table>
<thead>
<tr>
<th>Situation</th>
<th>Form 6038</th>
<th>Letter*</th>
<th>Form 8670</th>
<th>Form 3198-A</th>
</tr>
</thead>
<tbody>
<tr>
<td>501(c)(3) church</td>
<td>Complete</td>
<td>4587</td>
<td>NTEE</td>
<td>Write “Suspense” under “Other Instructions”</td>
</tr>
<tr>
<td></td>
<td>items 1-4 to the extent possible</td>
<td></td>
<td>NAICS</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Notate “Suspense”</td>
<td></td>
<td>Status: 74</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>501(c)(3) non-church</td>
<td>same as above</td>
<td>4587</td>
<td>NTEE</td>
<td>same as above</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>NAICS</td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Second screen</td>
<td></td>
</tr>
<tr>
<td>501(c) other</td>
<td>same as above</td>
<td>4587</td>
<td>Same as 501(c)(3) non-church</td>
<td>same as above</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>non-church</td>
<td></td>
</tr>
</tbody>
</table>

*Continued on next page*
Withdrawal

Introduction

IRM 7.20.2.13.3 - Processing Withdrawals states, "An organization may request, in writing, withdrawal of its application any time before the determination letter or proposed adverse determination letter is issued. Even though the application is withdrawn, the application and all supporting documents will be retained by the Service and not returned to the applicant. The request must be signed and dated by an officer/director/trustee of the organization."

The applicant may withdraw its application due to a number of reasons. For example, the organization may realize that it does not qualify for a favorable determination; the funding that the organization had hoped for may not be available; or all of the board members have resigned since the completion of the application.

Withdrawal as an Option

Specialists should avoid direct solicitation of withdrawals. They may explain why, based on the available information in the application, the organization does not appear to qualify for exemption. Withdrawal of an application may be discussed as an option.

Conversations with the applicant should be documented in the case chronology.

Instructor Notes

- Explain to the students not to directly solicit withdrawal from the applicant. Present withdrawal as an option.
- Request in Writing: Emphasize must be signed and dated by officer or director.
- User Fee: Emphasize user fee is not refundable. Should be explained to taxpayer and documented on CCR.

Request in Writing

A request for withdrawal of an application must be in writing, and signed and dated by an officer.

User Fee

The user fee is generally not refundable when the organization withdraws the application unless the organization already received exemption or is included in a group ruling. (See Rev. Proc. 2012-8 & IRM 7.21.2.5 regarding the refunding of user fees)
**Withdrawal, Continued**

**Instructor Notes**
Inform students a ROO Follow-up Request is required when an organization withdraws its application.

---

**Procedures for Closing a Case as a Withdrawal**

To close a withdrawal case, complete the following:

<table>
<thead>
<tr>
<th>Situation</th>
<th>Form 6038</th>
<th>Letter</th>
<th>Form 8670</th>
<th>Form 2363</th>
</tr>
</thead>
<tbody>
<tr>
<td>Withdrawal</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Notate -</td>
<td>2244</td>
<td>NTEE</td>
<td>If the organization is operational and had taxable income, then complete Form 2363 to establish a Form 1120 filing requirement (with the exception of churches, organizations already exempt under another subsection, and organizations covered under a group ruling).</td>
</tr>
<tr>
<td></td>
<td>“Application Withdrawn” in the Org Name section.</td>
<td></td>
<td>NAICS</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Request a ROO Follow-up</td>
<td></td>
<td>Status: 04</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>No second screen</td>
<td></td>
</tr>
</tbody>
</table>
The specialist transfers cases to EO Technical in the following situations:

a) The case cannot be resolved by established precedent and thus require interpretation of the tax law. (see IRM 7.20.1.4.1 for a list of cases reserved for EO Technical)

b) Cases where issues are subject to a study or not covered by clearly established precedent because they may have significant regional or national impact.


d) Technical assistance requests (Guidance from EO Technical on procedural or technical matters that do not relate to a specific case). (see Rev. Proc. 2012-5)

(See IRM 7.20.1.4 for more information regarding identification of EO Technical Cases)

All determination cases that are proposed for transfer to EO Technical are subject to mandatory review by Quality Assurance except the following:

- Applications under IRC 501(c)(14)
- Applications under IRC 501(c)(15)
- Applications under IRC 501(c)(25)
- Applications under IRC 501(c)(26)
- Applications under IRC 501(c)(27).

(See IRM 7. 20.5.4.(3) item r)
### Instructor Notes

Point out that EO Technical will return a case to the specialist if forwarding is not warranted. Therefore, the write-up about why the case is being forwarded should explain the reason(s) adequately.

Review Exhibit 17-4.

### Procedures

To close a case to EO Technical, complete the following and submit the case to your group manager for review.

**Note:** No letter is required for transferring a case to EO Technical.

<table>
<thead>
<tr>
<th>Situation</th>
<th>Form 3198-A</th>
<th>Form 8670</th>
<th>Form 6038</th>
<th>Form 3778 (See Exhibit 14-4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer case to EO Technical (subject to Quality Review)</td>
<td>Check the box “Mandatory Review” with instructions “Proposed transfer to EO Technical” in the Determination Cases section.</td>
<td>No Form 8670</td>
<td>Check Item 3b</td>
<td>Place an original and copy of Form 3778, Transmittal Memorandum, on the left side of the case file. The form must specify why the case needs to be forwarded to EO Technical, including adequate cites, e.g., specific IRM sections, paragraph number, revenue rulings, court cases, etc., that were considered and the reasons that they do not apply, or the reason for referral is lack of published precedent. Initial and date the bottom left corner of the file copy.</td>
</tr>
<tr>
<td>Transfer Non-Mandatory Review case to EO Technical (not subject to Quality Review)</td>
<td>Check the box “Forward to EO Technical” in the Determination Cases section.</td>
<td>No Form 8670</td>
<td>Check Item 3b</td>
<td>Same as above</td>
</tr>
</tbody>
</table>

IRS 01813
Correction Disposal

Instructor Notes

- A correction disposal is closed with status code “30” and is different from the status code “12,” which is miscellaneous closing. If the case should not have been established on EDS to begin with, then closing a case with “30” would be appropriate.

- Explain when status 12 should be used.

Introduction

A case is closed as “correction disposal” if the case has been erroneously established on EDS (e.g., if the case is a duplicate of a case already on EDS.)

Procedures

To close a case “correction disposal”, do the following:

<table>
<thead>
<tr>
<th>Situation</th>
<th>CCR</th>
<th>Form 6038</th>
<th>Form 3198-A</th>
<th>Form 8670</th>
</tr>
</thead>
<tbody>
<tr>
<td>Correction Disposal</td>
<td>Explain why the case should not have been established</td>
<td>N/A</td>
<td>N/A</td>
<td>The Status Code is “30”</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>No second screen</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Note: No time is charged on a “correction disposal”</td>
</tr>
</tbody>
</table>

Note: Include a note inside the case folder on the top, right side, indicating that the case is being closed without a letter.
Adverse Determinations

Instructor Notes

Emphasize to the students that, at this point in their training, involving the OJI or manager early is very important. Likewise is the thorough documentation in the case chronology.

Explain there is a QA public folder with denial information and current letters.

Introduction

If the case has the possibility of being denied, the specialist should involve the OJI or manager as soon as possible. This topic focuses on the procedures to close a case as “proposed denial” after other remedies have been considered and customer service, as described below, has been extended.

Before beginning the closing procedures, the specialist should:

- Develop the case to the extent that the adverse decision can be fully supported and justified
- Keep the manager informed about a possible denial and obtain the manager’s concurrence that exemption should be denied. Document discussions in the case chronology
- Call the organization and discuss why, based on the available information in the case file, the organization does not qualify for exemption

Document Taxpayer’s Position

The specialist should request that the organization provide its position and basis for its position or any additional information that may affect the specialist’s conclusion. This may be accomplished through a telephone conversation with the organization. Conversations with the organization should be documented in detail on the case chronology. However, the specialist should secure the organization’s position in writing in order to include it in the case file. A follow-up letter may be issued to request the organization’s position in writing.

Specialists are encouraged to resolve any discrepancies at the specialist level. The Denial checklist should be completed when working Adverse Determinations (see Exhibit 17-5).

Continued on next page
Adverse Determinations, Continued

**Instructor Notes**

If the organization indicates that it does not agree with the specialist and that it has additional information, the specialist may want to ask for this information in writing. The organization may indeed be able to provide information that would affect the specialist’s conclusion but not be able to provide it until much later. In this instance, both the specialist and organization may agree that the case should be closed Suspense to allow the organization more time to prepare its response.

**The specialist should try to resolve any discrepancies of fact and interpretation of the law at this level.**

Explain that proposed denials follow a special format. Review Exhibit 17-5.

**Proposed Adverse Determination Letter**

After careful review of the case file, if the specialist determines a denial is appropriate, the specialist will obtain the group managers concurrence with the denial. The specialist will contact the organization and explain IRC 6110 disclosure of their application. The specialist will prepare the appropriate Proposed Adverse Determination Letter and redacted copy of the Proposed Adverse Determination Letter.

- Letter 4036 should be prepared for proposed denial of exemption under IRC 501(c)(3).
- Letter 4034 should be prepared for proposed denial of exemption other than IRC 501(c)(3).

Continued on next page
Adverse Determinations, Continued

The Proposed Adverse Determination Letter must follow the format shown in Exhibit 14-11 and include the following:

- A legend of the letters, etc, that are used in the determination letter as substitutes for information that is exempt from public disclosure under section 6110 (e.g., names, addresses, locations and other identifying information).
- The Uniform Issue List (UIL) Index on the first page.
- Any Third Party Contacts
- Issues
- Facts
- Law
- Application of Law
- Taxpayer’s Position
- Service Response to Taxpayer’s Position
- Conclusion
- Enclosure, Publication 892 on the last page.

(Refer to IRM 7.20.5.6, Processing Adverse Determination Letters, IRM 7.20.4.10, IRC 6110 Public Inspection of Written Determinations (draft) and IRM 7.20.2.9, Adverse Determination Cases Overview for specific guidance)

<table>
<thead>
<tr>
<th>Instructor Notes</th>
<th>Denials of exemption require a ROO Follow-up.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Review Exhibit 17-6.</td>
</tr>
</tbody>
</table>

Procedures to Close a Case as Adverse

The following information addresses the procedures to follow in closing a case as an adverse determination. Additional information on adverse determinations can be found on the NERD Drive and in IRM 7.20.2.9.
The proposed denial should be assembled on the inside of the case folder in the following order:

<table>
<thead>
<tr>
<th>Left</th>
<th>Right</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Top to bottom</strong>:</td>
<td><strong>Top to bottom</strong>: In an adverse case, follow normal case file assembly procedures, except the information listed below will be placed first in the following order:</td>
</tr>
<tr>
<td>Form 5464-A (CCR)</td>
<td>1) Proposed adverse letter (1 for each recipient)</td>
</tr>
<tr>
<td>Denial Checklist (See Exhibit 14-6)</td>
<td>2) Publication 892</td>
</tr>
<tr>
<td></td>
<td>3) Copy of proposed adverse letter stapled together for Quality Assurance</td>
</tr>
<tr>
<td>* Current procedures require an electronic copy of the letter be sent to QA via secure messaging.</td>
<td>4) Index</td>
</tr>
</tbody>
</table>

The outside of the case folder should include the following from top to bottom:

- Form 3198-A
- Form 8670
Form 6038, EO Determination Case Checksheets

Instructor Notes

Explain the purpose of the checksheet is to ensure that uniform standards are applied to all EO determinations.

Purpose

Form 6038 was developed to insure that uniform standards are applied to all exempt organization determinations.

It is used as a checklist of necessary actions that must be completed before a determination is finalized and not as an all-inclusive technical worksheet. In some cases, additional work papers must be included as well. They will be covered in the respective lesson.

The form is prepared only when closing an I case. The first part of the form is the checklist. The agent will check each block appropriately. At the bottom of the front page is a section for other issues, comments, and conclusions. The agent will indicate “See Attached” in this section. In situations where the case involved significant issues, Form 14261 (Exhibit 17-8) should be added to the Form 6038 identified as issues. The agent should explain what the significant issues in the case were and how they were resolved.

Each work paper prepared for case closing must be initialed and dated by the preparer. This is generally done in the upper right-hand corner of each page.

(See IRM 7.20.2.13 - Case Closing (11-01-2004) for additional information)

Instructor Notes

- Indicate used only for I Cases.
- Refer students to Exhibit 17-7 and go over proper completion of Form 6038.
- Review Form 14261 – Memorandum to File in Exhibit 17-8.
Form 6038, EO Determination Case Checksheet, Continued

### Completing Form 6038

Form 6038 should be completed as follows:

- **Closed by Agent/Screener:** Since this form is completed on regular and “screened” cases, circle **Agent**

- **Name:** Name of specialist

- **Date:** Date the case is closed

- **Organization’s name**

- **Sections 1 through 4:** Check the appropriate box

- **Other Issues, Comments, Conclusion:** This information should be included in Form 14261 – Memorandum to File.

### Form 14261 – Memorandum to File

Provide a brief description of the activities that the organization conducts to achieve its exempt purposes.

Form 14261 contains five (5) sections: Activities, Issue(s) Identified, Analysis and/or Resolution, Law, and Conclusion.

- Under “Activities,” the agent will write a narrative, usually a paragraph, describing the activities of the organization.
- Under “Issue(s) Identified” the agent will detail the items requiring additional clarification and documentation.
- The “Analysis and/or Resolution” section should detail how the identified issues have been addressed by the agent.
- The “Law” section should contain a description of the precedent used to recommend exemption.
- The “Conclusion” should contain a brief statement justifying exemption.

*Continued on next page*
### Instructor Notes
- “Issues” - If a significant issue was developed and resolved, it should generally be listed. Often reviewed to determine if case time was commensurate with case difficulty.
- “Law” - Often a relevant revenue ruling is sufficient.

---

**Form 14261 – Memorandum to File – Issues Identified**

All major issues that have been identified and developed should be documented here. This section must be completed for ROO Referrals.

**Form 14261 – Memorandum to File – Law**

Cite any law and precedents that support your conclusion that the organization merits recognition of exemption.

The following may be cited:

- Internal Revenue Code
- Treasury Regulations
- Revenue Rulings and Procedures
- Court cases

GCMs, Technical Advice, etc. may be cited in addition to the above as a part of your rationale but may not be used as a legal basis for exemption.

When citing the law and precedents, try to be as specific as possible. For example, citing a specific revenue ruling with similar facts as those in your case would be more “on point” than merely citing “charitable in IRC section 501(c)(3).”

---

**Form 14261 – Memorandum to File – Conclusion**

Provide a brief statement justifying exemption. This section should also contain a brief explanation of the organization's Foundation classification.
Closing Letters

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Pub 4221 must be included with the closing to a (c)(3) organization.</td>
</tr>
<tr>
<td>• Review Exhibits 17-9 and 17-10.</td>
</tr>
</tbody>
</table>

EDS Letters

Most closing letters are computer-generated letters from the Letter Generation Subsystem (LGS) on EDS. Closing worksheets for the following EDS letters may be found in NERD Drive.

- Exhibit 17-9: Letter 947 (Public Charity),
- Exhibit 17-10: Letter 948 (Non-501(c)(3) Exemption
- Exhibit 17-11: Letter 1075 (Private Operating Foundation)
- Exhibit 17-12: Letter 1076 (Private Foundation)
- Exhibit 17-13: Letter 4587 (Suspense)

These letters have been approved by EO Technical and Notice Clarity to ensure uniformity. However, these letters do not cover all situations and specialists cannot alter these letters. In those cases, the specialist will have to compose the closing letter.

Number of Copies

Generally, two copies of the closing letters are needed: one for the applicant and one for the file. If a Form 2848, Power of Attorney, is in the case file, the representative also receives a copy.
Closing Documentation

Instructor Notes

- Explain the purpose of the closing worksheet is to provide the necessary information necessary for the establishment and closing of a case on EDS.
- Doc 6379 - Hard copy is often referred to as the “Blue Book”.

How the Closing Worksheet Relates to EDS

After a case is established on EDS, the information can be updated as the application proceeds through the determination process.

Upon the completion of the determination process, the case must be closed on EDS and the pertinent data is transmitted to EO Master File. A history of the case will be maintained on EDS.

Form 8670 contains the information necessary for the establishment and closing of a case on EDS.

Only one Form 8670 is necessary in most cases.

Document 6379 as Quick Reference

The information on Form 8670 is input on two separate screens. Instructions for the items on this form are in one or more IRMs, but Document 6379 provides a quick reference for most of them. Document 6379 can be found on our website at http://core.publish.no.irs.gov/docs/pdf/45128i07.pdf.

Certain information (name, address, EIN, DLN, case number, fiscal year, etc.) is input at the time the case is established. Review these data at case closing and correct if necessary.

Continued on next page
Information is entered on EDS and printed.

Use the following guide when completing the closing worksheet:

<table>
<thead>
<tr>
<th>Item</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxonomy Code</td>
<td>Completed for all exempt organizations.</td>
</tr>
<tr>
<td>(NTEE Code)</td>
<td></td>
</tr>
<tr>
<td>(NAICS Code)</td>
<td></td>
</tr>
<tr>
<td>Date</td>
<td>Enter the date case closed</td>
</tr>
<tr>
<td>Status</td>
<td>Enter the appropriate closing status:</td>
</tr>
<tr>
<td></td>
<td>01 – Approved</td>
</tr>
<tr>
<td></td>
<td>03 – Missing Information</td>
</tr>
<tr>
<td></td>
<td>04 - Withdrawal</td>
</tr>
<tr>
<td></td>
<td>06 - Closed on Merit No Contact</td>
</tr>
<tr>
<td></td>
<td>09 – Closed on Merit with Contact</td>
</tr>
<tr>
<td></td>
<td>11 - Suspense</td>
</tr>
<tr>
<td></td>
<td>12 - Other</td>
</tr>
<tr>
<td></td>
<td>30 - Correction Disposal</td>
</tr>
<tr>
<td></td>
<td>See Doc. 6379 for other status codes</td>
</tr>
<tr>
<td>Specialist No.</td>
<td>Verify your specialist number</td>
</tr>
<tr>
<td>Hours</td>
<td>Enter total time charged including</td>
</tr>
<tr>
<td></td>
<td>screener’s time</td>
</tr>
<tr>
<td>Filing Requirement</td>
<td>Enter appropriate filing requirements:</td>
</tr>
<tr>
<td></td>
<td>990 = 01 Gross Receipts &gt; 50,000</td>
</tr>
<tr>
<td></td>
<td>990 = 02 Gross Receipts &lt; 50,000</td>
</tr>
<tr>
<td></td>
<td>990 = 09 Suspense</td>
</tr>
<tr>
<td></td>
<td>990 = 06 Church</td>
</tr>
<tr>
<td></td>
<td>941 = 01 salaries indicated</td>
</tr>
<tr>
<td></td>
<td>940 = 1 salaries indicated on</td>
</tr>
<tr>
<td></td>
<td>non-IRC 501(c)(3)</td>
</tr>
<tr>
<td></td>
<td>990PF = 1 PF</td>
</tr>
<tr>
<td></td>
<td>1041 = Trust Suspense</td>
</tr>
<tr>
<td></td>
<td>1120 = Corporation Suspense or association</td>
</tr>
<tr>
<td></td>
<td>990T = UBIT</td>
</tr>
<tr>
<td></td>
<td>Others: See Document 6379</td>
</tr>
</tbody>
</table>

Continued on next page
## Closing Documentation, Continued

| Employment Code | 
|-----------------|-------------------------|
| **W** for IRC 501(c)(3) approvals | Blank - all others |

<table>
<thead>
<tr>
<th>Item</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Class Code</strong></td>
<td></td>
</tr>
</tbody>
</table>
| IRC 501(c)(3) | 1 - Charitable  
2 - Educational  
3 - Literary  
4 - Cruelty to Animals  
5 - Cruelty to Children  
6 - Public Safety  
7 - Religious  
8 - Scientific |
| IRC 501(c)(4) | 1 - Civic League  
2 - Local Association of Employees  
3 - Social Welfare |
| IRC 501(c)(6) | 1 - Board of Trade  
2 - Business League  
3 - Chamber of Commerce |

<table>
<thead>
<tr>
<th>Determination Code</th>
<th></th>
</tr>
</thead>
</table>
| 01 - Approved  
70 - Denied  
71 - Suspense |

| Effective Date - YYYYYMM | Enter the effective date for exemption |

<table>
<thead>
<tr>
<th>Affiliation Code</th>
<th></th>
</tr>
</thead>
</table>
| 3 - Must enter a 3  
If the organization is a parent or subordinate, Form 2363-A must be completed. |

| Ruling Date - YYYYYMM | Enter the year-month exemption is granted |

*Continued on next page*
### Closing Documentation, Continued

<table>
<thead>
<tr>
<th>Item</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Foundation Code</strong></td>
<td>03 - POF&lt;br&gt;04 - PF&lt;br&gt;10 - Church&lt;br&gt;11 - School&lt;br&gt;12 - Hospital&lt;br&gt;15 - 170(b)(1)(A)(vi)&lt;br&gt;16 - 509(a)(2)&lt;br&gt;17 - 509(a)(3)&lt;br&gt;Note: Enter for IRC 501(c)(3) only</td>
</tr>
<tr>
<td><strong>Adv. Ruling Ends - YYYYMM</strong></td>
<td>Leave Blank</td>
</tr>
<tr>
<td><strong>Deductibility Code</strong></td>
<td>Enter a 1 if Contributions are deductible&lt;br&gt;IRC 501(c)(3), VFD, and School Bldg. Co, etc.&lt;br&gt;Enter a 2 if Contributions are not deductible</td>
</tr>
<tr>
<td><strong>Deductibility Year</strong></td>
<td>Enter the year deductibility begins&lt;br&gt;Note: ENTER ONLY IF DEDUCTIBILITY CODE IS A 1.</td>
</tr>
<tr>
<td><strong>Entity Type</strong></td>
<td>1 - Corporation&lt;br&gt;2 - Trust&lt;br&gt;5 - Association</td>
</tr>
<tr>
<td><strong>Pension Plan</strong></td>
<td>1 - Organization has a pension plan&lt;br&gt;2 - Organization does not have a pension plan</td>
</tr>
<tr>
<td><strong>Group Exemption No.</strong></td>
<td>Only for group exemptions</td>
</tr>
</tbody>
</table>

**Document 6379** Refer to Document 6379 for a complete list of applicable codes. The above list includes commonly used codes only.
Practice Exercises

Exercise 17-1  True or False?

All information submitted in support of a request for exemption should remain part of the permanent administrative file?

Answer: False. Note: Only that information submitted that is the basis for granting exempt status should remain in the administrative file. All other information that is extra and not pertinent to the granting of exempt status should be purged, labeled, and clearly marked to prevent including such materials on microfiche.

Exercise 17-2  Which of the following may not be cited as law and precedent in support of your conclusions regarding the granting of tax-exempt status?

(a)  Internal Revenue Code
(b)  IRM 7.25 and 7.26
(c)  Revenue Rulings and Procedures
(d)  Court Cases

Answer: (b). Note: IRM 7.25 and 7.26 may not be cited as authority or precedent for purposes of granting or denying tax exempt status. The manuals provide citations from law and precedence to assist you in citing your authority.

Exercise 17-3  Generally, how many copies of the closing letter are required under the following circumstances?

Case closing with no power of attorney: 2
Case closing with power of attorney: 3

Continued on next page
Exercise 17-4
When additional information is requested from an organization and the organization fails to respond to the request and fails to request orally or in writing an extension of time to respond, the determination specialist will proceed to close the case as: ______________________
Answer: Suspense. Note: The organization has 21 days to respond to a request for additional information. If after 35 days there has been no response or no oral or written request has been received to extend the time to submit the information, the case will be closed as a suspense after making the required phone contact attempts to the taxpayer. (Phone call attempts are required after 21 days and again at the 35th day before the case can be closed Suspense).

Exercise 17-5
Which of the following would not be accepted as an organization's reason for the withdrawal of an application for exempt status?
(a) The organization realizes it does not qualify for exempt status
(b) The funding the organization sought to operate is no longer available
(c) All board members have resigned since the filing of the application for exemption
(d) All of the above are acceptable reasons for an organization to request a withdrawal of its request for exemption
Answer: (d). Note: All of the above reasons would be valid reasons for an organization to request a withdrawal of an application for exemption.
Exercise 17-6  True or False?

In the event a determinations specialist determines the organization would not qualify for exemption under the Code section for which they applied, the specialist should request that the organization withdraw their application request.

Answer: False. Note: The specialist may explain the reasons why he/she feels the organization does not qualify for exemption. Options available to the organization may be discussed. The specialist should avoid a direct solicitation of a request to withdraw from the organization and document all conversations with the taxpayer regarding their failure to qualify and options given to them by the specialist.

Exercise 17-7  Identify one of the reasons a determination request would be transferred to EO Technical.

Answer: A case will be transferred to EO Technical if it is specifically required in the IRM (7.20.1.4.1) or the case has present questions not specifically covered by statute, Treasury Regulations, court decisions, or precedents published in the Internal Revenue Bulletin.

Exercise 17-8  A case is closed as ___________________  _____________________ if the case has been erroneously established on EDS.

Answer: Correction Disposal (status 30)
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Summary

When the specialist closes a case, it is important that certain procedures are followed. This ensures the case file can be reviewed efficiently, the correct information is entered in the EO/Business Master File, the organization receives its determination, and the case file is routed appropriately.

Common case closing forms include Form 3198-A, Form 2363-A and Form 2363.

When a written request for additional information has been made and the applicant is not providing the necessary information, the case may be closed as Suspense.

An organization may withdraw its application at any time before the determination letter is issued. The application and supporting documentation is retained by the Service. Generally, user fees are not refunded to the organization if they choose to withdraw their application.

Some determination cases are transferred to EO Technical. These include cases reserved for EO Technical, case that require technical assistance, and cases with issues that cannot be resolved by established precedent or have a national impact.

If the case has the possibility of being denied, the specialist should involve the OJI or manager as soon as possible. All other remedies should be considered prior to preparing a proposed denial. You must have the group manager’s concurrence prior to working the case as a denial.

Form 6038 was developed to insure that uniform standards are applied to all exempt organization determinations.

Most closing letters are computer-generated letters from the Letter Generation Subsystem (LGS) on EDS.

Forms 14285, 14286, 14287, 14288, and 14289 contain the information necessary for the closing of a case on EDS.
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# Exhibit 17-1

## Form 3198-A

### TE/GE Special Handling Notice

<table>
<thead>
<tr>
<th>Required Entries</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Person to Contact:</td>
<td>Employee ID #:</td>
</tr>
<tr>
<td>Phone #:</td>
<td>PBC:</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EIN/SSN:</th>
<th>MFT:</th>
<th>Plan/Report #:</th>
<th>Years/Period Ended:</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>TIP Name:</th>
<th>EARLIEST STATUTE DATE IS:</th>
<th>for YEAR</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Name Control:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entity Change Form 2363 Prepared</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EOMF/BMF Change Form 2363-A Prepared</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Send all communications per POA</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Mandatory Review/Operations, Planning & Review

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unpaid Case</td>
<td>Installment Agreement</td>
</tr>
<tr>
<td>Sample Review</td>
<td>Forward to Appeals</td>
</tr>
<tr>
<td>Tech Advice</td>
<td>Management Identified</td>
</tr>
<tr>
<td>Proposed Adverse</td>
<td>Stat Notice Issued Date:</td>
</tr>
<tr>
<td>Penalties/issue Letter</td>
<td></td>
</tr>
</tbody>
</table>

### Expedite Processing

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankruptcy Case #:</td>
<td>Claim Case</td>
</tr>
<tr>
<td>Over $50,000 UNPAID</td>
<td>Other (Specify)</td>
</tr>
<tr>
<td>Manual Refund</td>
<td></td>
</tr>
</tbody>
</table>

### Special Features

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CEP/SPTA/TEP Case</td>
<td>Referral</td>
</tr>
<tr>
<td>TEFRA Case</td>
<td>Referral to Director of Practice</td>
</tr>
<tr>
<td>Discrepancy Adjustment</td>
<td>Closing Agreement</td>
</tr>
<tr>
<td>NOL - Carryback/Carryforward</td>
<td>Third Party Contact Form(s)</td>
</tr>
<tr>
<td>Exempt Penalty Case</td>
<td>Informant Claim</td>
</tr>
<tr>
<td>6722 Penalty Case</td>
<td>Dispute (Cycle Time)</td>
</tr>
<tr>
<td>Freeze from Refunding (Explain below in Other Instructions)</td>
<td>Update to status 55</td>
</tr>
<tr>
<td>Excise Tax on IRA</td>
<td>Project Initiative - Type:</td>
</tr>
<tr>
<td>SFIR - Substitute for Return to be Processed</td>
<td>Project Check Sheet Required</td>
</tr>
<tr>
<td>Delinquent Return to be Processed</td>
<td>Other Instructions</td>
</tr>
</tbody>
</table>

### EPIC/EOIC Closing Instructions

<table>
<thead>
<tr>
<th>Date Closed to Manager/Mgrs initial:</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Update Status Code:</td>
<td></td>
</tr>
<tr>
<td>Disposal Code:</td>
<td></td>
</tr>
<tr>
<td>Project Code:</td>
<td></td>
</tr>
<tr>
<td>Source Code:</td>
<td></td>
</tr>
<tr>
<td>Close to:</td>
<td></td>
</tr>
</tbody>
</table>

|  |  |
| APU1 | APU5 |
| REV1 | APV7 |
| REV1 | CLAS7 |

<table>
<thead>
<tr>
<th>Customer Contact:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Telephone Number:</td>
<td></td>
</tr>
</tbody>
</table>

### Determination Cases

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Form 5666</td>
<td>Form 6564</td>
</tr>
<tr>
<td>Forward to EO Technical</td>
<td>Failure to Establish</td>
</tr>
<tr>
<td>Failure to Establish</td>
<td>Termination, 6104(c) State Notification</td>
</tr>
<tr>
<td>User Fee Return</td>
<td>Other (Specify)</td>
</tr>
</tbody>
</table>

### Special Interest Features - ESS Use Only

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>6205 Interest Free Adjustment Date:</td>
<td>2% HOT GATT Date of 30-day letter</td>
</tr>
<tr>
<td>6434(g) Notice Date</td>
<td>Other Code Section</td>
</tr>
<tr>
<td>2nd Notice Date:</td>
<td>Penalties:</td>
</tr>
<tr>
<td>Interest Netting</td>
<td>Late 6551(a)(1)</td>
</tr>
<tr>
<td>Restricted Interest Case:</td>
<td>Failure to Pay 6551(a)(2)</td>
</tr>
<tr>
<td>IRC Section:</td>
<td>Estimated Tax 6564</td>
</tr>
<tr>
<td>Interest Computation Date</td>
<td>Accuracy 6562 ( )</td>
</tr>
<tr>
<td>Multiple Agreements:</td>
<td>Other ( )</td>
</tr>
<tr>
<td>Date of First RAR</td>
<td></td>
</tr>
<tr>
<td>Comments:</td>
<td></td>
</tr>
</tbody>
</table>

### Other Instructions

---

Form 3198-A (Rev. 7-2005)  
Catalog Number: 32225H  
Department of the Treasury-Internal Revenue Service  
IRS 01833
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Form 2363-A

Request for IDRS Input for BMF-EO Entity Change

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>000 014</td>
<td>000 000 012 013 014 016</td>
<td></td>
</tr>
</tbody>
</table>

7. New name control

8. Primary name

9. Continuation of Primary Name

10. Sort name (Trade, "Doing business as", Chapter, Local number, or abbreviated name, etc.)

11. "In care of" name

12. Foreign Street

13. Mailing Street or foreign city/ZIP

14. Mailing city/state or ZIP of foreign country

15. Location street address

16. Location city/state or ZIP

17. Subsection code

18. Foundation code

19. Classification code

20. Affiliation code

21. Type of organization (YYYY/MM)

22. Status code and date (YYYY/MM)

23. Ruling date (YYYY/MM)

24. Activity codes

25. Deductibility code and year (YYYY)

26. From idEN

27. New idEN

28. File form number

29. District location

30. Pension plan

31. Adv. ruling dt. (YYYY/MM)

32. Large case code

33. Sum list Ind.

34. Employment code

35. Fiscal year/month (MM)

36. NTEE

37. NAICS Code

38. Filing Requirements

<table>
<thead>
<tr>
<th>941</th>
<th>940</th>
<th>942</th>
<th>943</th>
<th>1120</th>
<th>1065</th>
<th>1041</th>
<th>5227</th>
<th>990</th>
<th>995-C</th>
<th>995-PF</th>
<th>995-T</th>
<th>NFR</th>
</tr>
</thead>
</table>

39. Remarks (required on all inputs)

40. Prepared by (Signature/Date)

41. Organization symbols

42. TE IDRS Number

43. TE Phone Number

Form 2363-A (Rev 3-2003) Cat. No. 21682K Department of the Treasury—Internal Revenue Service
This page intentionally left blank.
### Form 2363

**Exhibit 17-3**

<table>
<thead>
<tr>
<th>Trans. Code</th>
<th>Purpose</th>
<th>Filing Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>014</td>
<td>Change address</td>
<td>IMF: 941, 1129, 720, 1341, 1051, 940, 1043 US, 6950, 907</td>
</tr>
<tr>
<td>017</td>
<td>Change/Assign SSN</td>
<td>IMF: 941, 1129, 720, 1341, 1051, 940, 1043 US, 6950, 907</td>
</tr>
<tr>
<td>040</td>
<td>To valid segment</td>
<td>IMF: 941, 1129, 720, 1341, 1051, 940, 1043 US, 6950, 907</td>
</tr>
<tr>
<td>044</td>
<td>To invalid segment</td>
<td>IMF: 941, 1129, 720, 1341, 1051, 940, 1043 US, 6950, 907</td>
</tr>
</tbody>
</table>

**Prepared by**

**Org. Symbols**

**Area**

**Prepared from (Document and DLN)**

**Routing to**

---

**IRS 01837**
Internal Revenue Service
memorandum

Exhibit 17-4

Internal Revenue Service

subject: Application for Recognition of Exemption

☐ IRC 501 (c)
☐ IRC 501 (d)
☐ IRC 501 (e)
☐ IRC 501 (f)

In re: [Redacted]

The attached exemption application is forwarded for the following reason(s):

☐ (a) Application involves issue on which there is inadequate published precedent as explained below: [Use separate sheet if necessary]

Facts:

Issue:

Published precedents considered and reasons why they are not applicable:

☐ (b) Application involves issue requiring National Office consideration under section [Redacted] of I.R.M. 7660.

Attachment

Form 3778 (Rev. 8-1982)  Cat. No. 19833M

Internal Revenue Service
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<table>
<thead>
<tr>
<th>Denial Checklist</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manager’s concurrence (document CCR)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Called applicant to discuss proposed denial</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Secured applicant position</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepared proposed denial letter</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Created Legend according to 6110 disclosure procedures</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Modified body of letter by replacing redactable information with appropriate letter designation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inserted UIL index on page one</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Described Issue(s)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Described Facts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Described Law</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Described application of the Law</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Described applicant’s position</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Described service response to applicant’s position</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Completed the conclusion</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Saved denial letter to a computer disk &amp; placed in file</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enclosed Publication 892</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Completed Index</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tabbed &amp; Acco-Fastened File</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Completed Form 8670</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Completed Form 3198 (mandatory review-denial of exemption)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Included notes for Manager and/or Quality Assurance</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
This page intentionally left blank.
Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.
Issues

Does M qualify for exemption under section 501(c)(3) of the Code? If there are multiple issues, list each issue in this section.

Facts

- State how formed/date (corporation, association, trust)
- State purposes (normally as stated in organization document)
- State applicable governing controls and governance issues (e.g., from the by-laws, etc.) that affect exemption and/or classification
- State and describe activities. Explain relationship with any other entities that affect your applicant. If there are qualifying and non qualifying activities, discuss their relative significance, preferably in percentages.
- Describe revenue (sources of income) and expenses (expenditures)

Law

- Code
- Regulations
- Revenue Rulings
- Court Cases

Cite the most pertinent law supporting your denial. Also, list any precedent that the applicant cited or that seem to be in the applicant’s favor. The Code and Regulations may be recited verbatim or partially cited or paraphrased. Revenue Rulings and Court Cases should be summarized.

Application of Law

Description of how the law applies to the facts of the case. This should describe how the applicant’s situation is similar or dissimilar to the organization described in each citation.

Applicant’s Position

If the applicant provides their position, it should be summarized here. Do not extensively rehash material already presented in other sections. If there are discrepancies in the facts or between the facts and the applicant’s arguments, then they should be clarified before the case leaves the group and should be described in the letter.

Service Response to Applicant’s Position

Specialists should state where the we agree and where we disagree with the applicant’s position, and summarize why our position is still adverse to the applicant’s. Do not restate law or cite new law. Merely summarize that because of xxx, as described in the preceding facts and analysis, applicant does not qualify.

Conclusion
Brief summary of why the applicant does not qualify for exemption under section 501(c)(3) of the Code. Conclusion should be succinct and answer the questions posed in the issue section.

[Insert: Facts, law, and rationale]

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views to this office, fully explaining your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter to the address given at the end of this letter. We will consider your statement and decide if how the information affects our determination. If your statement does not provide a basis to for reconsideration of our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading “Regional Office Appeal”. The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed accompanied by the following declaration:

“Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete.”

Your appeal will be considered incomplete without this statement. The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization’s representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please contact the person identified in the heading of this letter by telephone to confirm that he or she received your fax.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, such as Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.
If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to: Deliver to:
Internal Revenue Service Internal Revenue Service
EO Determinations Quality Assurance EO Determinations Quality Assurance
Room 7-008 550 Main Street, Room 7-008
P.O. Box 2508 Cincinnati, OH 45202
Cincinnati, OH 45201

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please contact call the person identified in the heading of this letter by telephone to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert S. Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure, Publication 892
### Form 6038

**Exempt Organization Determination Case Checksheet**

<table>
<thead>
<tr>
<th>1. Governing Documents:</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Power provision properly limited?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Purpose(s) within meaning of section applied for?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. Dissolution provision adequate?</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2. Activities</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Statement of specific purposes and activities included?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Meet operational test with sufficient documentation?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. Evidence of inurement?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. Evidence of unrelated business income?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e. Legislative activities?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f. Political activities (IRC 527(f))?</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3. Special feature case involved:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Special requirements met?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. National Office issue or review necessary?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4. IRC 501(c) Organizations:</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Submitted timely application?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Qualifies under IRC 509(a)(1) &amp; 509(a)(2) &amp; 509(a)(3)</td>
<td>Definitive</td>
<td>Advance</td>
<td></td>
</tr>
<tr>
<td>c. Operating foundation?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. IRC 508(e) provisions?</td>
<td></td>
<td></td>
<td>State Law</td>
</tr>
<tr>
<td>e. Private schools - Has Rev. Proc. 75-50 been complied with?</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| 5. Other Issues, Comments, Conclusions: | |

---

IRS 01847
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Exhibit 17-8

Memorandum to File
EO Determinations Case Closing

<table>
<thead>
<tr>
<th>Organization Name:</th>
<th>Specialist/Screener Name:</th>
</tr>
</thead>
<tbody>
<tr>
<td>EIN:</td>
<td>Date:</td>
</tr>
</tbody>
</table>

Instructions:
Merit cases: Complete Items 2 & 3 to document issues identified/resolved and risks taken
Non-merit (full-development) cases: Complete Items 1 through 5

1. Activities:

2. Issue(s) Identified (Required for ROO Referrals):
   a.
   b.
   c.

3. Analysis and/or Resolution:
   a.
   b.
   c.

4. Law:

5. Conclusion:
This page intentionally left blank.
Exhibit 17-9

<table>
<thead>
<tr>
<th>NAME OF ORGANIZATION</th>
<th>EIN:</th>
</tr>
</thead>
<tbody>
<tr>
<td>EDS CASE NUMBER:</td>
<td></td>
</tr>
<tr>
<td>SPECIALIST NUMBER:</td>
<td></td>
</tr>
<tr>
<td>LETTER 947 - 501(c)(3)</td>
<td></td>
</tr>
</tbody>
</table>

Selective paragraphs (see TAB 8)

<table>
<thead>
<tr>
<th>Item</th>
<th>Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY (Month/Day, Ex. January 31)</td>
<td>8010</td>
</tr>
<tr>
<td>Foundation Status, Ex. 170(b)(1)(A)(vi)</td>
<td>8011</td>
</tr>
<tr>
<td>Form 990</td>
<td>8012</td>
</tr>
<tr>
<td>Effective date (Month/Day/Year)</td>
<td>8013</td>
</tr>
<tr>
<td>Contribution Deductibility</td>
<td>8014</td>
</tr>
<tr>
<td>Addendum</td>
<td>8015</td>
</tr>
<tr>
<td>Required for 509(a)(3) only:</td>
<td>3088</td>
</tr>
<tr>
<td>Type 1 = operated, supervised, or controlled by</td>
<td></td>
</tr>
<tr>
<td>Type 2 = supervised or controlled in connection with</td>
<td></td>
</tr>
<tr>
<td>Type 3 = operated in connection with</td>
<td></td>
</tr>
<tr>
<td>POA</td>
<td>5998</td>
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</table>

Special Instructions:

LETTER 947
FORM 8670 GENERATION

<table>
<thead>
<tr>
<th>NAICS Code</th>
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</thead>
<tbody>
<tr>
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<td>Hours</td>
<td>Grade:</td>
</tr>
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</table>

Filing Requirements:

941:WW 1120:CC 1041:T
1065:P 940:F 990C:
990T: 5227:N 990PF:P
990:00

Employ. Code | Class. Code**
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Determination Code</td>
<td>01</td>
</tr>
<tr>
<td>Affiliation Code</td>
<td>3</td>
</tr>
<tr>
<td>Foundation Code **</td>
<td>Deductibility Year (YYYY):</td>
</tr>
<tr>
<td>Deductibility Code</td>
<td>Pension Plan: 2</td>
</tr>
<tr>
<td>Entity Type</td>
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Group Exemption Number
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### Exhibit 17-10

**LETTER 948 - non-501(c)(3)**

**Selective paragraphs (see TAB 8)**

<table>
<thead>
<tr>
<th>Section</th>
<th>1</th>
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<tbody>
<tr>
<td>FY (Month/Day, Ex. January 31)</td>
<td>8010</td>
</tr>
<tr>
<td>Form 990</td>
<td>8012 Yes/No</td>
</tr>
<tr>
<td>Effective Date (Month/Day/Year)</td>
<td>8013 Yes/No</td>
</tr>
<tr>
<td>Contribution Deductibility</td>
<td>8014 Yes/No</td>
</tr>
<tr>
<td>Addendum</td>
<td>8015 Yes/No</td>
</tr>
<tr>
<td>POA</td>
<td>5998 Yes/No</td>
</tr>
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</table>

**Special Instructions:**

**LETTER 948 FORM 8679 GENERATION**

---

### SCREEN 1

*Verify accuracy of name, name control, address, EIN, and accounting period on EDS*

- NAICS Code: __________
- Taxonomy Code: __________
- Date: __________
- Status: __________
- Grade: __________
- Specialist #: __________

---

### SCREEN 2

**Filing Requirements:**

- 941:WW: __________
- 1120:CC: __________
- 1041:T: __________
- 1065:P: __________
- 946:F: __________
- 990C: __________
- 990T: __________
- 5227:N: __________
- 990PF:P: __________

**Employ. Code**

<table>
<thead>
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<th>Class. Code**</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Eff. Date (YYYYMM):</td>
</tr>
<tr>
<td>3</td>
<td>Ruling Date (YYYYMM):</td>
</tr>
<tr>
<td></td>
<td>Deductibility Year (YYYY):</td>
</tr>
<tr>
<td></td>
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Exhibit 17-11

NAME OF ORGANIZATION: [Blank]

EDS CASE NUMBER: [Blank]

SPECIALIST NUMBER: [Blank]

LETTER 1075 - POF

Selective paragraphs (see TAB 8)

FY (Month/Day, Ex. January 31) 8010 [Blank]
Effective date (Month/Day/Year) 8011 [Blank]
Addendum 8012 [Yes/No]
POA 5998 [Yes/No]

Special Instructions:

LETTER 1075
FORM 8670 GENERATION

VERIFY ACCURACY OF NAME, NAME CONTROL, ADDRESS, EIN, AND ACCOUNTING PERIOD ON EDS

<table>
<thead>
<tr>
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<td>Date</td>
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SCREEN 2

Filing Requirements:

<table>
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<th>1120:CC</th>
<th>1041:T</th>
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<tbody>
<tr>
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</tr>
<tr>
<td>990:00</td>
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Employ. Code   Class. Code**

Determination Code 01  Eff. Date (YYYYMM):  
Affiliation Code 3  Ruling Date (YYYYMM):  
Foundation Code  
Deductibility Code  
Entity Type  
Pension Plan: 2
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**Exhibit 17-12**

<table>
<thead>
<tr>
<th><strong>Name of Organization:</strong></th>
<th>EIN:</th>
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</thead>
<tbody>
<tr>
<td><strong>EDS Case Number:</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Specialist Number:</strong></td>
<td></td>
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**LETTER 1076 - PF**

**Selective paragraphs (see TAB 8)**

- **FY (Month/day, Ex. January 31):** 8010
- **Effective date (Month/Day/Year):** 8011
- **Addendum:** 8012  Yes/No
- **POA:** 5998  Yes/No
- **Scholarships:** 3229 or 3233 & 3224

**Special Instructions:**

---

**LETTER 1076**

**FORM 8670 GENERATION**

**SCREEN 1**

Verify accuracy of name, name control, address, EIN, and accounting period on EDS

<table>
<thead>
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</tr>
</thead>
<tbody>
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<tr>
<td>Hours:</td>
<td>Grade:</td>
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**SCREEN 2**

**Filing Requirements:**

- 941:WWW
- 1065:P
- 990T:
- 990:00

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<tbody>
<tr>
<td>Determination Code</td>
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<tr>
<td>Foundation Code**</td>
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<tr>
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**Exhibit 17-13**

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<tbody>
<tr>
<td>Code Section</td>
<td>1</td>
</tr>
<tr>
<td>Return Address</td>
<td>*</td>
</tr>
<tr>
<td>Select One (indicate paragraph number):</td>
<td></td>
</tr>
<tr>
<td>501(c)(3) non-church**</td>
<td>9</td>
</tr>
<tr>
<td>Non-501(c)(3) Farmers' Coop**</td>
<td>10</td>
</tr>
<tr>
<td>501(c)(3) church</td>
<td>11</td>
</tr>
<tr>
<td>(no variable)</td>
<td></td>
</tr>
<tr>
<td>POA</td>
<td>5998</td>
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<td>Yes/No</td>
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### LETTER 1314 - FTE

<table>
<thead>
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<th>8010</th>
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<tbody>
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<tr>
<td>Select One (indicate paragraph number):</td>
<td></td>
</tr>
<tr>
<td>501(c)(3) non-church**</td>
<td>2</td>
</tr>
<tr>
<td>Non-501(c)(3) Farmers' Coop**</td>
<td>3</td>
</tr>
<tr>
<td>501(c)(3) church</td>
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<tr>
<td>(no variable)</td>
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</tr>
<tr>
<td>POA</td>
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<td>Yes/No</td>
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**Special Instructions:**

### FORM 8670 GENERATION

**SCREEN 1**

Verify accuracy of name, name control, address, EIN, and accounting period on EDS

<table>
<thead>
<tr>
<th>NAICS Code</th>
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</tr>
</thead>
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<tr>
<td></td>
<td></td>
<td></td>
<td>11/12**</td>
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</table>

**Status Code = 11 on all except churches**

**Stop Here on Status 12 FTE's**

### SCREEN 2

**Filing Requirements**:  

<table>
<thead>
<tr>
<th>Type</th>
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<th>Class Code</th>
<th>Eff. Date (YYYYMM)</th>
<th>Ruling Date (YYYYMM)</th>
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<th>Pension Plan</th>
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<tbody>
<tr>
<td></td>
<td>71</td>
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<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>N/A</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>N/A</td>
<td>2</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>2</td>
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<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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Chapter 18
Case Review

Instructor Preparation

Estimated Time 2 hours

Reference Materials IRM 7.20.5.4(2)

Training Aids
• TA18-1, Objectives

Notes to Instructor
Prepare a flipchart or PowerPoint slide for the objectives.
Chapter 18
Objectives

After completing this chapter, you will be able to:

• Identify TEQMS standards and elements.

• Identify which cases are sent to mandatory review.

• Identify which cases are sent to EO Technical for post review.
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Chapter 18
Case Review

Overview

Introduction
Exempt Organizations cases may be reviewed at the following levels:

- Managerial Review
- Tax Exempt Quality Measurement System (TEQMS)
- Mandatory Review by Exempt Organizations Determinations Quality Assurance (EODQA)
- Post Review by EO Technical
- Group Reviews
- Saturation Reviews
- Special Reviews
- Manager’s Discretion Reviews

All cases are not reviewed at every single level. Most cases are only reviewed at the managerial level. TEQMS cases are randomly selected for review. Some types of cases are set aside for mandatory review. Some cases are sent to EO Technical for a post review after EODQA has completed its processing.

Presently, elementary and secondary private schools located in Mississippi and Louisiana are sent to EO Technical for a post review. The Director, Rulings and Agreements, may agree to perform a post review of other types of cases based on a request in writing from the Manager, EO Determinations.

Instructor Notes
- Stress the importance of following all required procedures in working and closing a case file, to avoid having the case returned for procedural or technical errors.
- Display and review the Objectives on the flip chart or using the PowerPoint slide.

Continued on next page
Overview, Continued

Objectives
At the end of this chapter, you will be able to:

- Identify TEQMS standards and elements.
- Identify which cases are sent to mandatory review.
- Identify which cases are sent to EO Technical for post review.

Reference Materials
IRM 7.20.5.4(2)

Contents
This chapter contains the following topics:

<table>
<thead>
<tr>
<th>Topic</th>
<th>See Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overview</td>
<td>1</td>
</tr>
<tr>
<td>Types of Review</td>
<td>3</td>
</tr>
<tr>
<td>Sample Scenario of Several Levels of Review</td>
<td>11</td>
</tr>
<tr>
<td>Practice Exercises</td>
<td>12</td>
</tr>
<tr>
<td>Summary</td>
<td>14</td>
</tr>
</tbody>
</table>
Types of Review

<table>
<thead>
<tr>
<th>Instrucor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mention that IRM 7.20.5 contains all information on review procedures for EO Determinations. For example, IRM 7.20.5.2 contains a detailed description of QA’s purpose and function and includes a full list of reviewer’s duties.</td>
</tr>
</tbody>
</table>

Managerial Review

You close a case to your group manager for managerial review. If your group manager concurs with your determination, they sign off on the case and forward the case for final processing.

If your group manager does not concur with your determination and believes that the case needs more development (or has an error), they update the case status and return the case to you. If you have any questions or concerns about the case, you should discuss them with your group manager. Be sure to thoroughly document the CCR when the case was returned, why it was returned, and the steps taken to resolve the issue.

<table>
<thead>
<tr>
<th>Instructor Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Refer to IRM 7.20.5.4(2) for the official definition of TEQMS.</td>
</tr>
</tbody>
</table>

TEQMS Review

After a group manager signs off on a case, it may be randomly selected for review as part of the Tax Exempt Quality Measurement System (TEQMS). In TEQMS, a statistically valid sample of EO determination cases is reviewed. The cases are evaluated by use of a check sheet to determine whether certain predetermined standards are satisfied. This process is handled by the EO Determinations Quality Assurance (EODQA) staff where the cases are reviewed in accordance with specific guidelines found in the TEQMS Student Guide (Training Document 4319-002).

Continued on next page
The information obtained by the Quality Assurance staff from the TEQMS reviews is used to measure the overall quality of the work product in accordance with established quality standards for EO determination matters.

The Quality Assurance staff issues quarterly reports and provides other forms of guidance as to the quality scores on various important features of determination work. These important features are called standards and elements.

The TEQMS reports also provide suggestions as to how specialists and managers may improve quality. However, the TEQMS feedback is anonymous and does not refer to individual specialists, managers, or groups. The Quality Assurance staff cannot return a TEQMS case to a specialist unless the case meets case return criteria that are specified in the TEQMS Student Guide.

The TEQMS review of regular determination cases includes the following six Standards:

1. Complete Application
2. Timeliness
3. Technical Issues
4. Workpapers Support Conclusion
5. Case Administration
6. Customer Relations / Professionalism

Continued on next page
## Types of Review, Continued

<table>
<thead>
<tr>
<th>TEQMS Merit Closure Elements</th>
<th>The TEQMS review of Merit Closures includes the following six Elements:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Proper Form 6038 Completion</td>
</tr>
<tr>
<td></td>
<td>2. Proper Identification of Merit Closure</td>
</tr>
<tr>
<td></td>
<td>3. Proper Determination Letter</td>
</tr>
<tr>
<td></td>
<td>4. Appropriate Case Assembly and Closing Actions</td>
</tr>
<tr>
<td></td>
<td>5. Timeliness</td>
</tr>
<tr>
<td></td>
<td>6. Customer Relations / Professionalism</td>
</tr>
</tbody>
</table>

### Instructor Notes

Below: Point out differences between Mandatory Review and TEQMS – determination letters on TEQMS cases are not held until the case is reviewed by QA. Accordingly, TEQMS cases are seldom returned to the specialist, even if they contain errors.

Categories: Stress that this portion of the IRM is updated frequently to add or remove categories. Specialists should ensure they are using a current version of this IRM section.

Continued on next page
Types of Review, Continued

**Mandatory Review**

Certain types of cases have been identified as requiring more scrutiny because of technical difficulty, sensitivity, or other reasons. These cases are subject to mandatory review by EODQA. Unlike TEQMS cases, the mandatory review cases are not randomly selected; instead, all cases in the categories shown below must be sent to EODQA after managerial review.

Another difference from TEQMS is that the Quality Assurance staff may more frequently return mandatory review cases to the specialists for corrections or improvements. A similarity with TEQMS is that Quality Assurance issues quarterly reports as to the general trends and opportunities for improvement observed on the mandatory reviews. These findings are presented in the quarterly Mandatory Trend Reports, which are saved for reference in the EODQA subfolder of Outlook Public Folders.

**Categories for Mandatory Review**

IRM 7.20.5 provides further guidance about mandatory review and lists the following categories subject to review:

- Private and public schools, but only if:
  - They are located in Mississippi or Louisiana, including charter schools and home schools
  - They were previously denied recognition of exemption
  - They are a successor to a for-profit organization
  - They engage services from a management services organization
  - They provide management services to one or more charter schools

- Foreign organizations (not including those formed in U.S. possessions)

- Previously revoked organizations

- Proposed denials, failure to establish denials, and certain adverse foundation status determinations (except those involving organizations with less than $125,000 in gross receipts)

- Technical advice requests

*Continued on next page*
Types of Review, Continued

Categories for Mandatory Review (continued)

- Impact cases
- Certain health care organizations
- Cases subject to IRC 6110 disclosure (amendment cases involving IRC 4945(g) advance approval of individual grants)
- Farmers’ cooperatives
- Credit counseling
- Group rulings (including cases in which we decline to issue a group ruling)
- Partnership cases
- Religious and apostolic organizations under IRC section 501(d)
- Exempt operating foundations
- Limited Liability Companies (“LLCs”)
- “War related” cases such as those providing assistance to victims of the war
- Cases in which an applicant’s request for Reg. 301.9100-1 relief is not granted (and only if they do not accept IRC section 501(c)(4) exemption for the prior period)
- Proposed transfers to EO Technical, with the exception of IRC sections 501(c)(14), 501(c)(15), 501(c)(25), 501(c)(26), and 501(c)(27)
- TAG (Touch and Go) cases identified as abusive
- Conservation easements
- IRC section 4945(f) ruling requests

Continued on next page
Types of Review, Continued

- IRC section 4942(g) set-asides
- Voluntary requests for private foundation status
- Small voluntary employees’ beneficiary associations (i.e., IRC section 501(c)(9) organizations with 20 or fewer members entitled to receive benefits)
- Applications involving sensitive political issues such as:
  - Voter registration
  - Inaugural and convention host committees
  - Post-election transition teams
  - Voter guides
  - Voter polling
  - Voter education
  - Other activities that may appear to support or oppose candidates for public office
- Group manager designated (Manager’s discretion)
- Other cases selected for review by the Manager, EO Quality Assurance, such as:
  - Saturation review
  - Special review
  - Group review

Continued on next page
Types of Review, Continued

What if You Have a Case in One of These Categories?

Whenever you encounter any of these cases, you should identify them as subject to mandatory review by completing a Form 3198-A and placing it on the outside of the folder prior to submitting the case for approval by your group manager.

EODQA Memos

If EODQA determines that your case needs more development or that the case contains an error, they may return the case to your group manager on an inquiry review memo. EODQA will complete Form 5456, Reviewer’s Memorandum – EP/EO, with the box for “Inquiry” checked.

If your group manager agrees with EODQA, he/she may return the case to you. Refer to IRM 7.20.5.5.2. You should then take the corrective actions and return the case to EODQA through your manager on a Form 5457, Response to Reviewer’s Memorandum – EP/EO. Any necessary attachments should be continued on Form 886-A, Explanation of Items.

If you disagree with the findings of EODQA on an inquiry review memo, you should clarify any potential misunderstandings with your group manager. If your group manager still agrees with EODQA, you should adopt their position in further dealings with the organization. However, if your group manager agrees with your position, you should document all reasons for disagreement on Form 5457. Your group manager will then advise the Manager, EO Quality Assurance, of the disagreement, either through discussion or by approving Form 5457. Refer to IRM 7.20.5.5.3 for guidance on how to address any further disagreements.

In addition to inquiry review memos, EODQA also may issue advisory memos to you through your manager. EODQA will complete Form 5456, Reviewer’s Memorandum – EP/EO, with the box for “Advisory” checked. An advisory review memo is usually issued to inform you of a correction made in EODQA or to suggest a better way to work certain kinds of cases in the future. On most advisory review memos, you do not have to take any further action or respond to the memo.

Commendatory memos are used to congratulate the specialist for doing an excellent job.

Continued on next page
**Types of Review, Continued**

**Post Review**

Some cases must be sent to EO Technical for a post review after EODQA has completed its processing. Currently, elementary and secondary private schools located in Mississippi and Louisiana are sent to EO Technical for a post review.

If you approve such a private school from Mississippi or Louisiana, it is first reviewed by your group manager. It is then reviewed by EODQA and then forwarded to EO Technical for a post review. The case is no longer in an open status when it is forwarded to EO Technical. The processing of the case is not delayed and the applicant organization is mailed its determination letter. If EO Technical believes a correction is necessary, the case will be returned to EODQA and then possibly to you (through your manager) for corrective action.

The Director, Rulings and Agreements, may agree to perform a post review of other types of cases based on a request in writing from the Manager, EO Determinations.

Further information about post review may be found in IRM 7.21.3.8.
Sample Scenario of Several Levels of Review

School A, from Mississippi, applied for exemption under IRC section 501(c)(3). School A provides a traditional curriculum for students in grades 7 through 12. School A is controlled by a board appointed by Church B.

The determinations specialist approved School A’s application for exemption under IRC section 501(c)(3). The determinations specialist further determined that the organization qualified as a school as described in IRC sections 509(a)(1) and 170(b)(1)(A)(ii) and that the school had a Form 990 filing requirement.

The group manager and EODQA both concurred with the determinations specialist and the case was closed as an approval and a 947 determination letter was mailed to School A. The application file was then sent to EO Technical for a post review.

EO Technical concluded that the organization did qualify for exemption under IRC section 501(c)(3) and further concluded that the foundation status as a school was also correct. However, since School A was in fact controlled by Church B, EO Technical determined that the organization should be exempt from the Form 990 filing requirement. EO Technical sent the file back to EODQA for further consideration.

EODQA agreed with the EO Technical observations and therefore reopened the case and returned it to the specialist, through the manager, on an inquiry review memo (Form 5456). The memo asked that the specialist prepare a new determination letter that would show that the organization was not required to file annual returns on Form 990.

The determinations specialist agreed with the corrective action proposed by EODQA and therefore prepared a new 947 letter in which he indicated that the organization did not have a Form 990 filing requirement. The new letter had a addendum, which clearly stated that this 947 letter superseded the earlier letter. The specialist prepared Form 5457, Response to Reviewer’s Memorandum – EP/EO, and sent it and the case back to his manager who approved the specialist’s response.

The case was then sent on to EODQA where it was closed and the corrected letter mailed.
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Practice Exercises

Exercise 18-1  List three levels/types of case review.

Answer: (Any three of the following are correct.)

- Managerial Review
- Tax Exempt Quality Measurement System (TEQMS)
- Mandatory Review by Exempt Organizations Determinations Quality Assurance (EODQA)
- Post Review by EO Technical
- Group Reviews
- Saturation Reviews
- Special Reviews
- Manager’s Discretion Reviews

Exercise 18-2  Name three types of cases that are subject to mandatory review.

Answer: (Any three of the following are correct.). IRM 7.20.5 lists mandatory review cases as:

- Private and public schools, but only if:
  - They are located in Mississippi or Louisiana, including charter schools and home schools
  - They were previously denied recognition of exemption
  - They are a successor to a for-profit organization
  - They engage services from a management services organization
  - They provide management services to one or more charter schools

- Foreign organizations (not including those formed in U.S. possessions)
- Previously revoked organizations
- Proposed denials, failure to establish denials, and certain adverse foundation status determinations (except those involving organizations with less than $125,000 in gross receipts)
- Technical advice requests
- Impact cases
- Certain health care organizations
- Cases subject to IRC 6110 disclosure (amendment cases involving IRC 4945(g) advance approval of individual grants)

Continued on next page
Exercise 18-2 (continued)

- Group manager designated or other cases selected for review by the Manager, EO Quality Assurance
- Farmers’ cooperatives
- Credit counseling
- Group rulings (including cases in which we decline to issue a group ruling)
- Partnership cases
- Religious and apostolic organizations under IRC section 501(d)
- Exempt operating foundations
- LLCs
- “War related” cases such as those providing assistance to victims of the war
- Cases in which an applicant’s request for Reg. 301.9100-1 relief is not granted (and only if they do not accept IRC section 501(c)(4) exemption for the prior period)
- Proposed transfers to EO Technical, with the exception of IRC sections 501(c)(14), 501(c)(15), 501(c)(25), 501(c)(26), and 501(c)(27)
- TAG (Touch and Go) cases identified as abusive
- Conservation easements
- IRC section 4945(g) ruling requests
- IRC section 4942(g) set-asides
- Voluntary requests for private foundation status
- Small voluntary employees’ beneficiary associations (i.e., IRC section 501(c)(9) organizations with 20 or fewer members entitled to receive benefits)
- Applications involving sensitive political issues such as:
  - Voter registration
  - Inaugural and convention host committees
  - Post-election transition teams
  - Voter guides
  - Voter polling
  - Voter education
  - Other activities that may appear to support or oppose candidates for public office
Exempt Organizations cases may be reviewed at the following levels:

- Managerial Review
- Tax Exempt Quality Measurement System (TEQMS)
- Mandatory Review by Exempt Organizations Determinations Quality Assurance (EODQA)
- Post Review by EO Technical
- Group Reviews
- Saturation Reviews
- Special Reviews
- Manager’s Discretion Reviews

The most common type of review you will experience is a managerial review. You close a case to your group manager for managerial review. If your group manager concurs with your determination, they sign off on the case and forward the case for final processing. If your group manager does not agree then the case will be returned to you to resolve the outstanding issue.

In TEQMS, a statistically valid sample of EO determination cases is reviewed. The cases are evaluated by use of a check sheet to determine whether certain predetermined standards are satisfied. This process is handled by the EO Determinations Quality Assurance (EODQA) staff.

Certain cases are subject to Mandatory Review due to their technical difficulty, sensitivity or other reasons. These cases are reviewed by EODQA.
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