



**DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224**

**OFFICE OF  
CHIEF COUNSEL**

September 27, 2000

Number: **200046038**  
Release Date: 11/17/2000  
CC:TE/GE:EOEG:EO2  
TL-N-114-00  
UILC: 6033.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE SERVICE CENTER ADVICE

MEMORANDUM FOR AREA COUNSEL CC:TE/GE:PCCM  
(PACIFIC COAST AND CENTRAL MOUNTAIN AREA)  
TAX EXEMPT AND GOVERNMENT ENTITIES

FROM: Assistant Chief Counsel CC:TE/GE:EOEG  
(Exempt Organizations/Employment Tax/Government  
Entities)  
Office of Division Counsel/Associate Chief Counsel  
(Tax Exempt and Government Entities)

SUBJECT: Significant Service Center Advice

This responds to your request for Significant Advice dated April 21, 2000, in connection with a question posed by the Submission Processing Center (OSPC) function of the Ogden Service Center.

ISSUE

Whether a Service Center that converts a Form 990, Return of Organization Exempt From Income Tax, filed by a section 501(c) organization that has not filed for recognition of tax-exempt status and is not required to file Form 1023, Application for Recognition of Exemption Under Section 501(c)(3), or Form 1024, Application for Recognition of Exemption Under Section 501(a), to a Form 1120, U.S. Corporation Income Tax Return, can proceed without an examination to issue a statutory notice of deficiency, if the organization refuses to sign the return?

CONCLUSION

If Service Center converts a Form 990 filed by a section 501(c) organization that has not filed, and is not required to file, for recognition of tax-exempt status to a Form 1120, the Service cannot proceed without an examination to issue a statutory notice of deficiency, if the organization refuses to sign the return. In addition, we question whether treatment of these returns as unpostable Form 990s by the Service Center is appropriate.

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## FACTS

The Ogden Service Center has a recurring problem with organizations that file Form 990, Return of Organization Exempt From Income Tax, but have not filed Form 1023, Application for Recognition of Exemption Under Section 501(c)(3), or Form 1024, Application for Recognition of Exemption Under Section 501(a). These returns are unpostable because these organizations have not filed for recognition of exempt status and therefore, the organizations are not included on the Master File. The Service Center proposes to solve this problem by substituting Form 1120, U.S. Corporation Income Tax Return, for the Form 990, based on the assumption that these organizations are not tax exempt, because they have filed neither Form 1023 nor Form 1024.

## LAW AND ANALYSIS

Organizations described in section 501(c)(3) are generally required by section 508 to apply for recognition of their tax-exempt status by using Form 1023. Certain section 501(c)(3) organizations are not required by section 508(c) and Treas. Reg. § 1.508-1(a)(3) to seek recognition of tax-exempt status, but may elect to do so. The organizations exempt from this filing requirement include churches, their integrated auxiliaries, and conventions and associations of churches; organizations that are not private foundations and have gross receipts not normally exceeding \$5,000; subordinate organizations (other than private foundations) to another tax-exempt organization that are covered by a group exemption letter; and for certain purposes only, section 4947(a)(1) trusts, which were organized before October 9, 1969,

Section 501(c) organizations described in paragraphs other than section 501(c)(3) generally are not required to notify the Service that they are seeking tax-exempt status. However, section 505(c) and Treas. Reg. § 1.505(c)-1T require that section 501(c)(9) voluntary employees' beneficiary associations and section 501(c)(17) trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits must apply to the Service for recognition of their tax-exempt status using Form 1024. Because section 501(c) organizations other than those described in sections 501(c)(3), 501(c)(9), and 501(c)(17) are not required to obtain recognition from the Service of their tax-exempt status, these organizations qualify for exemption, if they meet the requirements of the Internal Revenue Code.

Nevertheless, most of these organizations may voluntarily file Form 1024. It is appropriate for the Service to strongly encourage these organizations to apply for exemption to decrease the uncertainty of their tax status. Treas. Reg. § 1.501(a)-1(a)(2) notes that "[I]n order to establish its exemption, it is necessary that every such organization claiming exemption file an application form . . . ." Publication

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557, Tax-Exempt Status for Your Organization (Rev. Nov. 1999), page 2, states that organizations “seeking recognition of exemption from federal income must use application forms . . . .” However, requiring the application to “establish “ or “seek recognition” of an organization’s exempt status is different from saying an organization is not exempt without the approval of an application by the Service. Joint Committee on Taxation, “Overview of Present-Law Rules and Description of Certain Proposals Relating to Disclosure of Information by Tax-Exempt Organizations With Respect to Political Activities” (JCX-59-00), June 19, 2000, page 53, states that section 501(c) organizations, other than section 501(c)(3), 501(c)(9), and 501(c)(17) organizations, are not required to notify the Service that they are seeking tax-exempt status. Under section 501(c), other than sections 501(c)(3), 501(c)(9) and 501(c)(17), organizations are legally exempt under section 501(a) if they are described in those sections regardless of whether they applied to the Service for recognition of that status.

Tax-exempt organizations generally are required by section 6033 to file an annual information return, usually a Form 990, Return of Organization Exempt From Income Tax, with the Service. An organization that has not obtained recognition from the Service, but claims tax-exempt status under section 501(c) is subject to the same annual reporting requirements and exceptions as organizations that have had their tax-exempt status recognized by the Service. Section 6033(a)(2)(A) and Treas. Reg § 1.6033-2(g) provide that this annual information return requirement does not apply to several categories of tax-exempt organizations, including churches, their integrated auxiliaries, conventions or associations of churches, certain organizations (other than private foundations) the gross receipts of which in each taxable year are normally not more than \$25,000, exclusively religious activities of any religious order, section 501(c)(1) instrumentalities of the United States, section 501(c)(24) trusts described in ERISA section 4049, an interchurch organization of local units of a church, certain mission societies, and certain church-affiliated elementary and high schools. We believe Form 990s are filed each year for organizations that are not required to file and that have elected not to file for recognition of tax-exempt status under section 501(c). These organizations qualify for exemption, if they meet the requirements of the Internal Revenue Code.

Upon the receipt of a Form 990, Service Center procedures require a check of the organization’s employer identification number (EIN) to determine whether the organization has been recognized as exempt from taxation by the Service. IRM 7.3.1, Chapter 12.1, EP/EO Processing Function Handbook, provides that unpostable conditions occur when transactions cannot post to the Master File, the Business Master File, and the Employee Plans Master File because of invalid data. IRM 7.3.1, Chapter 5, AIMS Special Processing Procedures, Exhibit 7.3.1.5.1, provides that the Business Master File (BMF) is a magnetic tape file of business entity and return data, including EO entity and return data. Exhibit 7.3.1.5.1 defines substitute for return, as a procedure used when the organization refuses or is

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unable to file appropriate return(s) even though the information received indicates that return(s) should have been filed. IRM 7.3.1.5.16.4 provides that in an agreed case in which a Form 990 is converted to Form 1120, the 1120 can be posted to the Master File. For an unagreed case, IRM 7.3.1.5.16.4(4) provides that the Form 1120 substitute for return should be placed in the case folder. The Form 1120 should neither be forwarded to the service center for processing to the MF nor should an account be established on the Audit Information Management System (AIMS). The case should be closed to Appeals in the normal manner.

These IRM provisions do not support the immediate issuance of a statutory notice of deficiency in an unagreed case in which a Form 1120 has been substituted for a Form 990. The organization that filed the Form 990 may satisfy the requirements for tax-exempt status in the Internal Revenue Code and have not been required to file Form 1023 or Form 1024.

Therefore, we agree with your conclusion that the Ogden Service Center should not issue a statutory notice of deficiency, if the taxpayer refuses to either submit a Form 1120 or to sign a Form 1120 prepared by the Service. However, we disagree with your recommendation that all unpostable Form 990s should undergo examination. Instead, we question the whole concept of treating these returns as unpostable Form 990s. Most of these organizations are probably not required to file for recognition of tax-exempt status, and qualify for exemption if they meet the requirements of the Internal Revenue Code. We suggest as a possible solution that these returns could be posted to a modified system, perhaps a separate system or classification for Form 990s filed by organizations that have not applied for recognition of tax-exempt status. If an audit program is undertaken, perhaps there could be a random selection of a number of these "unpostable" returns for examination to determine if a larger program is warranted.

If you have any further questions, please call Sylvia Hunt at 202-622-6010 or me at 202-622-6070.

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