

S. REVIEW OF CURRENT ISSUES UNDER IRC 508

1. Introduction

This article is intended to supplement previous EOATRI and EO CPE articles concerning IRC 508 and to discuss several issues regarding the notice requirements of that section.

2. Background

IRC 508(a) provides generally that an organization organized after October 9, 1969, will not be treated as described in IRC 501(c)(3) unless it gives notice to the Service in an appropriate manner. Reg. 1.508-1(a)(2)(i) provides, in part, that this notification requirement is satisfied when an organization seeking exemption under IRC 501(c)(3) files a properly completed and executed Form 1023 within 15 months from the end of the month in which it was organized.

Reg. 1.508(a)-1(a)(2)(iii) provides further that an organization will be considered "organized" on the date it becomes an organization described in IRC 501(c)(3).

The notification requirement set forth in IRC 508(a) is subject to exceptions and these are listed in IRC 508(c). Under IRC 508(c)(1) there are several exceptions to notice which are applicable to (A) churches, and their integrated auxiliaries, and conventions or associations of churches, or (B) any organization, other than a private foundation, the gross receipts of which in each taxable year are normally not more than \$5,000.

3. Retroactive Exemption Under IRC 508(c)(1)(B)

The exception in (B) above is discussed in Reg. 1.508-1(a)(3)(ii). That section explains that the gross receipts of an organization are normally not more than \$5,000 if:

- (1) During the first taxable year of the organization the organization has received gross receipts of \$7,500 or less;

- (2) During its first two taxable years the aggregate gross receipts received by the organization are \$12,000 or less; and,
- (3) In the case of an organization which has been in existence for at least three taxable years, the aggregate gross receipts received by the organization during the immediately preceding two taxable years plus the current year are \$15,000 or less.

If an organization fails to meet any one of these requirements, then the organization must file the notice required by IRC 508(a) within 90 days after the end of the period described in (1), (2), or (3) for which it exceeded the dollar amount allowed. This 90 day period is in lieu of the 15 month period mandated in Reg. 1.508-1(a)(2)(i).

Rev. Rul. 81-177, 1981-27 I.R.B. 10, discusses an organization which had gross receipts of less than \$7,500 during its first taxable year but had aggregate gross receipts for its first two taxable years of more than \$12,000. It failed to file its application for exemption within 90 days of the close of its second taxable year. The Revenue Ruling holds that the three year test provided by Reg. 1.508-1(a)(3)(ii) is a cumulative test and failure to meet the requirements of the test in any one year results in failure to meet the test for each year involved.

Rev. Rul. 80-113, 1980-1 C.B. 58, discusses an organization that received no financial support from the date it was organized through a period of nearly 2 1/2 years whereupon it filed for recognition of exemption under IRC 501(c)(3). It requested a ruling treating it as being described in IRC 170(b)(1)(A)(vi) and IRC 509(a)(1) during an advance ruling period. The revenue ruling reasons that since the organization had no financial support prior to its application, it was not described in either section as of its application date, and, therefore, the exception in IRC 508(c)(1)(B) did not apply. (While the organization had less than \$12,000 aggregate support, it was not a public charity since it received no public support.) However, Rev. Ruls. 77-207, 1977-1 C.B. 152 and 77-208, 1977-1 C.B. 153, hold that organizations filing applications after the 15 month period has elapsed are neither described in IRC 501(c)(3) nor are they classified as private foundations under IRC 509(a) prior to their application filing dates. They are considered to be new organizations as of the application dates and may obtain advance ruling treatment. Based on these revenue rulings, Rev. Rul. 80-113 holds that an organization which has not received any financial support may receive an advance

ruling as an organization described in IRC 170(b)(1)(A)(vi) and IRC 509(a)(1) beginning on the date it filed its application, the date on which it is treated as a new organization and recognized as exempt under IRC 501(c)(3).

Rev. Rul. 80-113 is silent as to the length of the organization's advance ruling period. The underlying case file, however, reveals that its advance ruling period had expired and 90 days had past before application for recognition of exemption was filed. These facts are critical as can be seen by the following illustration. Consider the situation where an organization has no financial support for its first tax year consisting of less than 8 months, or for its second year of existence but does receive contributions in excess of \$15,000, constituting public support under IRC 170(b)(1)(A)(vi), in its third year. It then applies for recognition of exemption under IRC 501(c)(3) within 90 days after the end of the third tax year. Has the organization met the notice requirements of IRC 508(a) since it did file its application within 90 days of the end of the year in which it failed to qualify under the IRC 508(c)(1)(B) exception and is the exemption retroactive to the date of its formation? Or, since it had no receipts for its first two years and did not file within 15 months of its organization, can exemption only be recognized prospectively from the date application was made?

4. Arguments For Exemption From the Date of Formation

The exception to IRC 508(a) provided by IRC 508(c)(1)(B) requires that the organization availing itself of the exception not be a private foundation as defined in IRC 509(a). Under Reg. 1.170A-9(e)(5)(v), an initial determination of the status of a newly created organization as a private foundation is not made until that organization has completed a computation period which in this case, is the organization's first three tax years and for which period it is publicly supported as described in IRC 170(b)(1)(A)(vi). The Service, therefore, cannot treat this organization as a private foundation for purposes of IRC 509 and consequently not for purposes of IRC 508(c)(1)(B), which refers to IRC 509.

Rev. Rul. 80-113 does not serve to preclude exemption to this organization as the facts in that revenue ruling concern an organization that had no financial support whatsoever during its computation period. The organization under consideration did receive public support in its third year and did file within 90 days of the close of that tax year.

Finally, under Reg. 1.170A-9(e)(5)(vi), donors to this organization would assume the risk that this organization is publicly supported until the expiration of

the computation period for an initial determination of its status. Treatment of this organization as a private foundation pursuant to IRC 508 would negate the possibility available to donors under Reg. 1.170A-9(e)(5)(vi).

5. Arguments Against Exemption From The Date of Formation

The organization was not publicly supported for at least the first 15 months of existence. The exception to the IRC 508(a) notice requirement contemplates an organization's being publicly supported when it applies for exemption more than 15 months after its date of formation.

Since the organization was not publicly supported for its first 15 months, it did not meet its burden of showing that it was publicly supported then and there is no authority under IRC 508(a) to allow more than 15 months for the organization to apply for exemption as a publicly supported organization.

6. Summation

These arguments were recently considered in the National Office and the position that the organization had met the notice requirements of IRC 508(a) and, therefore, was exempt from the date of its formation, was favored; however, no final decision has been made. A revenue ruling project has been initiated to clarify the IRC 508 matters raised by this type of case.