

PUBLICATION

Spotlight On Exempt Organizations: Reinstating Exempt Status

July 6, 2011

The IRS recently identified more than 275,000 nonprofits that had their federal tax-exempt status revoked for failing to meet annual filing requirements for three consecutive years.¹ Losing tax-exempt status has serious implications for nonprofits--not only does such loss mean that the organization must pay federal income tax, but also that donors cannot take deductions for their contributions to otherwise qualifying charities and similar nonprofit organizations. Without the incentive of a tax deduction, many organizations' coffers will dry up when would-be donors choose to keep their money, or donate to a nonprofit that has a verifiable tax-exempt status. Further, it may also mean the revocation of any state tax exemptions that were dependent on the federal tax-exempt status.

These mass revocations are largely due to a change in federal law that many tax-exempts did not notice. Previously, only tax-exempt organizations with annual revenue of \$25,000 or more were required to file annual reports with the IRS. However, a federal law effective in 2007 requires all organizations to file returns, regardless of how much revenue the organization generates.² Because small nonprofits were familiar with the old rules exempting such nonprofits from annual filing requirements, and because a large number are operated by volunteers, the new law went undetected by many small nonprofits.

The revocation does not have to be permanent, however, and the IRS has recently issued guidance on reinstating tax-exempt status.³ Although different procedures apply for large and small organizations, much of the application process is similar. A nonprofit seeking reinstatement of its tax-exempt status under section 501(c)(3) must submit Form 1023--the form it originally filed to obtain tax-exempt status. Unfortunately, this can be a time-consuming procedure; the IRS estimates it will require 100 hours of work to complete the form. In addition to the application, all organizations seeking reinstatement must pay the appropriate user fee.

The effective date of reinstatement varies among applicants. For larger organizations (those whose gross receipts normally exceed \$50,000), the effective date of the organization's reinstated tax-exempt status will be the date of filing for reinstatement unless the organization can show "reasonable cause" for reinstatement effective retroactively to the date of revocation. Small organizations, on the other hand, are deemed to have shown reasonable cause and therefore are entitled to retroactive reinstatement if the organization meets the following criteria:

- The organization was not required to file annual information Returns (such as Form 990, *Return of Organization Exempt from Income Tax*) for taxable years beginning before 2007;
- The organization was eligible in each of its taxable years beginning in 2007, 2008, and 2009 to file a Form 990-N e-Postcard (rather than an annual information Return);⁴
- The organization had annual gross receipts of \$50,000 or less in its most recently completed taxable year; and
- On or before December 31, 2012, the organization submits to the IRS a properly completed and executed application for reinstatement of tax-exempt status.

Additionally, if the applicant small organization meets the above qualifications for transitional relief, the fee for reinstatement is reduced to \$100.

For more detailed information regarding the reinstatement procedure, see [IRS Notice 2011-44](#) (for the general rules) and [IRS Notice 2011-43](#) (for transitional relief available to small organizations).

Should you have any questions regarding these reinstatement procedures, or should you wish to discuss any other issues with respect to exempt organizations, please contact any attorney in the Firm's Tax Department.

¹ The IRS updates its list of revocations every month, and the list can be accessed here: www.irs.gov/charities/article/0,,id=240099,00.html

² In taxable years beginning in 2007, 2008, and 2009, organizations having \$25,000 or less in annual revenues were not required to submit the full-fledged annual *Return of Organization Exempt from Income Tax* (usually a Form 990), but instead a less-detailed Form 990-N e-Postcard. While small organizations can still file annual returns on the e-Postcard, the \$25,000 threshold was increased to \$50,000 for taxable years beginning on or after January 1, 2010. See [Rev. Proc. 2011-15](#).

³ The IRS recently published two "information letters" with respect to applying for reinstatement of tax-exempt status. Notice 2011-44 provides the general rules. Notice 2011-43 outlines the "transitional relief" available for small organizations that were caught off guard by the law. See Internal Revenue Service [Bulletin 2011-25](#) dated June 20, 2011.

⁴ Generally, organizations (other than private foundations and most section 509(a)(3) supporting organizations) with annual gross receipts that were normally not more than \$25,000 in such taxable years would have been eligible to file a Form 990-N e-Postcard.