P.L.R. 201446025 – A CHANGE OF I.R.S. DIRECTION?

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INTRODUCTION

U.S. charities are required to obtain I.R.S. approval in order to be exempt from federal income tax under §501(a) of the Internal Revenue Code (the "Code"). Under Code §508(a), new organizations must notify the Secretary of the Treasury that they are applying for recognition of Code §501(c)(3) status. In order to establish such exemption, Treasurey Regulation §1.1501(a)-1(a)(2) requires that an organization must file an appropriate application form with the district director for the internal revenue district in which the principal place of business of the organization is located. Furthermore, any rulings or determination letters holding the organization exempt are effective so long as there are no material changes in the organization's character, purposes, or methods of operation. To be tax-exempt under §501(c)(3), an organization must be organized and operated exclusively for exempt purposes and none of its earnings may inure to any private shareholder or individual.

This begs the following question: If a charity changes its organizational structure or state of incorporation, will a new application be required?

REVENUE RULING 67-390

In Revenue Ruling 67-390,[1] the I.R.S. considered whether new applications for exemption are required in four situations where organizations that are already exempt from federal income tax under §501(a) changed their structures.

Case 1. The organization is an exempt trust that is reorganized and adopts a corporate form to carry out the same purposes for which the trust was initially established.

Case 2. An exempt unincorporated association is incorporated and continues the operations which had previously qualified for exemption.

Case 3. An exempt organization that was incorporated under state law is reincorporated by an Act of Congress to continue carrying out the same operations.

Case 4. An exempt organization incorporated under the laws of one state is reincorporated under the laws of another state with no change in its purposes.

In these four cases, the I.R.S. found that new legal entities had been created, which must each reestablish their entitlement to exemption from federal income tax.

[1] Rev. Rul. 67-390, 1967-2 C.B. 179.

There are risks and burdens associated with requiring the refiling of the tax exemption form. Refiling means re-inviting the I.R.S. to scrutinize the organization's activities and financials and potentially being denied the exemption. The filing of the form itself is a burden, especially for long-established organizations that have a substantial number of programs, contracts, and relationships to disclose. With the recent decline in funding and resources, I.R.S. delays are ever-increasing. Donors may also misinterpret this process and suppose that the organization's charitable status has been revoked.

PRIVATE LETTER RULING 201446025

A recent private letter ruling has indicated that the I.R.S. may permit a charitable entity to effect changes in their organizational structure without the need for a new exemption letter.

Private Letter Ruling 201446025 (November 14, 2014) held that a change in the state of domicile of a nonprofit corporation was not a substantial change in the entity's character, purposes, or methods of operations, and therefore, the entity could rely on the previously-issued determination of tax-exempt status and would not be required to file a new application for exemption.

This letter ruling involved a nonprofit corporation formed on Date 1 by a certificate of formation filed in State 1. On Date 2, the entity received recognition of exemption under Code §501(c)(3) retroactive to its date of formation. The entity intended to file "Articles of Domestication" with State 2 and a "Certificate of Conversion" with State 1. The effect of these filings would be that the state of domicile would change from State 1 to State 2. The governing law of State 2 states that the filing of the Articles of Domestication will not affect the nonprofit's date of incorporation, which would remain Date 1. Further, the laws of State 2 provide that the entity is the same corporation as the one that existed under the laws of State 1. Similarly, the laws of State 1 provide that following the filing of a Certificate of Conversion, the entity will continue to exist without interruption, maintaining the same liabilities and obligations. The ruling stated that the nonprofit made this change because the laws of State 2 offered more flexibility. The charitable purposes and operations of the nonprofit did not change.

The letter ruling made reference to *American New Covenant Church v. Comm'r*, 74 T.C. 293, 301 (T.C. 1980), which considered the question of whether a new organization was formed when an exempt unincorporated association changed its name and also presented articles of incorporation bearing this new name. The I.R.S. determined that a new entity had been formed by the filing of these articles of incorporation. It concluded that (i) the newly-formed corporation was distinctive from the unincorporated association that had previously filed an application for exemption and (ii) the newly-formed corporation needed to file its own application. The United States Tax Court agreed, ruling "that the two organizations [should] be treated as separate, independent legal entities." It stated that the I.R.S., "was entirely justified in insisting that [the newly formed corporation] submit a new application in order to determine whether it met the regulation requirements for tax-exempt status." Rev. Rul. 77-469, 1977-2 C.B. 196 reached a similar conclusion, holding that that an organization that filed its application for exemption less than 15 months after its incorporation under state law was exempt as of the date of its incorporation, even though it had operated as an unincorporated association for three years prior to its

incorporation. The ruling highlighted that the corporation was a new legal entity from the unincorporated one. This position is understandable, as the legal status and governance rules of corporations and unincorporated associations are significantly different.

It also made reference to Rev. Rul. 67-390, 1967-2 C.B. 179, described above.

The I.R.S. held that the entity's State 2 domestication was not comparable to those of the organizations in Rev. Rul. 77-469, *American New Covenant Church v. Commissioner*, 74 T.C. 293, 301 (T.C. 1980), and Rev. Rul. 67-390 Cases 1 and 2. The organizations in those instances changed from an unincorporated association to a corporation or from a trust to a corporation, which was not the transaction under consideration. The domestication was held to be closer to Cases 3 and 4 of Rev. Rul. 67-390, both of which involved a reincorporation of an existing corporate entity. There was, however, a significant difference. Cases 3 and 4 involved a creation of a new legal entity, while under the domestication procedure in question, no new entity was created. The nonprofit simply filed an amendment to its formation document, rather than filing a new one, and therefore, the I.R.S. concluded that no new entity had been formed.

CONCLUSION

P.L.R. 201446025 is a major step in the right direction for the I.R.S., and some practitioners have suggested that this position be formalized in a published ruling.[2] Perhaps the I.R.S. will also recognize that there is no meaningful distinction between a change of state of domicile by conversion and a change by merger. If so, it would be an even greater step forward if Rev. Rul. 67-390 were revoked to eliminate the need for a new exemption letter when a charity changes its state of incorporation.

"Donors may also misinterpret this process and suppose that the organization's charitable status has been revoked"

[2] Nina Krauthamer was the primary author of a letter sent to the I.R.S. by the Non-Profit Organizations Committee of the New York City Bar requesting a formal ruling. That letter appears here.