

IRS Announces Elimination of Advance Ruling Process

By Dennis Walsh CPA

On September 9, 2008 the Internal Revenue Service announced the release of new regulations that eliminate the 5-year advance ruling period for new exempt organizations. If your nonprofit is less than 5 years old or you have not yet received a definitive ruling regarding your status as a public charity, the following information is of importance to you.

Under new regulations effective immediately, the IRS will automatically classify a section 501(c)(3) organization as a public charity, as opposed to a private foundation, for its first five years if it indicates in its application for recognition of exemption that it reasonably expects to be publicly supported. After the first five years, the IRS will monitor the organization's continuing eligibility for public charity status using the support information reported annually on Schedule A of Form 990.

What does this mean for you?

If your nonprofit received an advance ruling that you are classified as a public charity for your first 5 years, as is the case with most new exempt organizations, your original determination letter stating such becomes your definitive determination of public charity status. You and your donors may rely on your 501(c)(3) determination letter for evidence of public charity status. (Note: This development has no effect upon your original determination as a 501(c)(3) nonprofit.)

Specifically, if your 5 year advance ruling period is scheduled to expire on or after June 9, 2008, you will automatically be treated as a public charity for your first 5 years of existence, regardless of the actual makeup of your support during this time period. Refer to your IRS 501(c)(3) determination letter for the expiration date of your advance ruling period. Among other positive implications, This means that the excise tax on net investment income applicable to private foundations will not be retroactively applied in the event your nonprofit does not meet one of the public support tests during its first five years of existence.

This also means you will not need to file IRS Form 8734, Support Schedule for Advance Ruling Period, at the end of your first 5 years of existence as stated in your 501(c)(3) Determination letter from the IRS. Instead, IRS will monitor your continuing eligibility for treatment as a public charity from the support information you supply annually on Schedule A of Form 990, beginning with your 6th year of existence. If you are not otherwise required to file a Form 990 for any particular year (e.g. your annual support is less than \$25,000), you still do not need to file Form 990.

An organization with an advance ruling period expiring before June 9, 2008 is unaffected by this change. In other words, if your advance ruling period expired before this date and you haven't yet filed Form 8734 or you recently filed Form 8734 but haven't received your definitive ruling, this change will have no effect upon the process that you must follow for a definitive ruling of public charity status (i.e. you are still subject to the old rules).

A new exempt organization is classified as a private foundation unless it states in its application for recognition of exemption that it expects to qualify as a public charity under one of several support tests. Under the old rules, a new organization was eligible for a 5 year conditional classification as a public charity in order to provide time to determine if its actual support received qualified it as a public charity. The new Regulations eliminate this process by automatically treating a new organization as a public charity for its first 5 years. This is a welcome development for new nonprofits.

Why is public charity status significant?

Most private foundations receive substantial amounts of their support from a few sources rather than from contributions from a broad public base. Private foundations are subject to a host of restrictions, differences in reporting requirements not applicable to public charities, and various potential excise taxes, including a 1% or 2% tax on net investment income. Additionally, most private foundations must pay out at least 5% of their assets annually to avoid a hefty excise tax for failure to make sufficient charitable distributions.

Further, special rules apply to the tax deductibility of contributions by an individual to a private foundation, other than an operating foundation, that may limit the amount of a noncash contribution to less than fair market value or serve to postpone a donor's deduction for contributions of cash or noncash property.

This sometimes makes contributions to a private foundation less attractive than contributions to a public charity for tax reasons.

Please feel free to contact the [Financial Management HelpDesk](#) if you have any questions specific to your organization relating to this development.

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