

## **IRS Eliminates Advanced Ruling Period for Public Charities**

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By: Larry Levy and Cathleen West

The IRS recently changed the process to obtain formal classification as a public charity. Organizations that previously filed IRS form 1023 applications for recognition of tax-exempt status under 501(c)(3) which received advanced ruling determinations that expire on or after June 9, 2008 are automatically being classified by the IRS as publicly supported charities. As such, these organizations are no longer required to file form 8734 in order to demonstrate compliance with the public charity test for public support.

***Practice Tip: 501(c)(3) public charities should proactively consult with a qualified attorney, accountant or tax advisor when the organization is initially formed in order to address the public support test, even though the test will not be applied by the IRS until year six under the new rules.***

As we know, the test for public support is met by 501(c)(3) organizations that are exempt under 509(a)(1) (i.e. organizations that are funded mainly by donations from the general public) by demonstrating that it receives at least 1/3 of its support from the general public, public charities and/or the government. If an organization fails this test, then the IRS can evaluate it under an alternative test based on the facts and circumstances. In order to be evaluated under the facts and circumstances test, an organization must receive at least 10% of its support from the general public and/or government, and it must be organized and operated so as to attract new and additional public support on a continuous basis. Other factors which the IRS may consider under a facts and circumstances evaluation include: the sources of support, the percentage of support, whether there is a representative governing body, the availability of public services and facilities provided by the charity, and other additional factors pertaining to membership organizations.

With regard to a 501(c)(3) charity exempt under 509(a)(2) (i.e. organizations that receive their support from a combination of donations and fees for exempt activities), the public support test is met by demonstrating that not more than 1/3 of its financial support comes from gross investment income and that its receives more than 1/3 of its financial support from contributions, membership fees and gross receipts from activities related to its exempt functions. Whether or not a public charity has met the public support test is evaluated utilizing the current year and a four-year look-back period.

In September 2008, the IRS issued temporary regulations eliminating the advanced ruling procedures. Under the old rules, an organization filed form 1023 seeking recognition under 501(c)(3) by stating that it anticipated being a publicly supported charity on an on-going basis. If the application was approved, the organization was typically treated as a 501(c)(3) public charity for a 5-year period known as the "advanced ruling period." After the end of the 5-year period, the organization was then required to file form 8734 demonstrating that the organization had actually met the public support test. If the organization did not meet the public support test at that time,

then it was deemed a private foundation. Generally, private foundations are subject to a stricter regulatory regime as compared to public charities.

***Practice Tip: New organizations with a small number of donors may have trouble meeting the public support test, and should therefore consult a qualified tax advisor and accountant for advice on alternative solutions and/or the consequences of being deemed a private foundation.***

Under the IRS's new rules, organizations apply for public charity status, and approved organizations are automatically deemed such during their first five years. Then, beginning with year six, organizations are required to demonstrate that they meet the public support test by providing certain financial information on Schedule A of the form 990. The public support test utilized by the IRS continues to be based on a five year period consisting of the current year and the 4 years immediately preceding the current year. The evaluation of whether an organization is meeting the test for public support now begins in the sixth year. By instituting its new rules, the IRS has in effect simplified the process for obtaining public charity status by eliminating the advanced ruling determination period.

***Practice Tip: Organizations should consult with legal counsel to initiate fundraising from the general public, public charities and/or the government near the start of the five year public support test periods.***

Finally, previously under the old procedures, the IRS would notify organizations toward the end of their 5-year advanced ruling period and enclose a copy of the form 8734. However, since the issuance of the temporary regulations, the IRS has instead been notifying organizations of the new rules concerning public charity status. Note, the IRS indicated that it inadvertently mailed copies of form 8734 along with their notifications about the new rules to some organizations. However, organizations should not file form 8734 unless their advanced ruling periods ended prior to June 9, 2008.

***Practice Tip: Organizations that received advanced rulings that expire prior to June 9, 2008 are still required to file form 8734.***

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## **About the Author**

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