

May 20, 2013

## **FAQs on 501(c)(4) Social Welfare Organizations**

### ***What are 501(c)(4) social welfare organizations?***

Section 501(c)(4) social welfare organizations are tax-exempt organizations that have as their primary purpose engaging in social welfare activities. Section 501(c)(4) defines social welfare organizations as:

Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons . . . and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

See § 501(c)(4); Treas. Reg. § 1.501(c)(4)-1.

### ***What is a social welfare activity?***

Treasury Regulation § 1.501(c)(4)-1(a)(2)(i) provides that an organization qualifies as a § 501(c)(4) organization if “it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.” Lobbying is considered a social welfare activity as long as it is related to the organization’s exempt purpose.

### ***Why doesn’t political activity count as a social welfare function?***

Treasury Regulation § 1.501(c)(4)-1(a)(2)(ii) provides that “the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.” Lobbying and other activities to influence legislation are not considered political intervention.

***How is intervention in a political campaign defined for tax purposes?***

The IRS uses a facts and circumstances test to determine whether an organization is intervening in a political campaign. See Rev. Rul. 2007-41; Rev. Rul. 2004-06. The IRS indicated that key factors include: “1) whether the statement identifies one or more candidates for a give public office; 2) whether the statement expresses approval or disapproval for one or more candidates’ positions and/or actions; 3) whether the statement is delivered close in time to the election; 4) whether the issue addressed in the communication has been raised as an issue distinguishing candidates for a given office; 5) whether the communication is part of an ongoing series of communications by the organization on the same issue that are made independent of the timing of any election; and 6) whether the timing of the communication and identification of the candidate are related to a non-electoral event such as a scheduled vote on specific legislation by an officeholder who also happens to be a candidate for public office.” See Rev. Rule 2007-41. See also Rev. Rul. 2004-06 (listing other factors and examples).

Revenue Rule 2007-41 indicates, “A communication is particularly at risk of political campaign intervention when it makes reference to candidates or voting in a specific upcoming election.”

***What does it mean to be “tax-exempt”?***

In this context, “tax-exempt” means that the organization is not taxed on its income. Contributions to 501(c)(4) organizations are not included in the organization’s income and the organization is not taxed on income generated from activities related to its exempt function. Unlike 501(c)(3) charities, contributions to social welfare organizations are not tax deductible under § 170. (Businesses may be able to deduct some or all of dues paid to these organizations as ordinary and necessary business expenses under § 162).

***Must a social welfare organization apply for recognition of 501(c)(4) tax-exempt status?***

No. A social welfare organization is not required to file for tax-exempt status. It can be a “nondeclaring” social welfare organization. Even if an organization does not file for recognition, it is required to file a Form 990 information return. This return must be filed by the 15<sup>th</sup> day of the 5<sup>th</sup> month of the end of the taxable year. The organization can also seek a 6-month extension. Thus a social welfare organization may choose not to file an information return for 22.5 months after its creation. See Treas. Reg. § 1.6033-1(e).

### ***What is a Form 990 and is it public?***

A Form 990 is an information annual return filed by tax-exempt organizations. See § 6033. Organizations are required to make their Form 990s available to the public either by request or the organizations make the Form 990 widely available (for example by posting it on the Internet). See § 6104(a), (d). Although the Form 990 includes information regarding contributors who give at least \$5,000, that information is not made public. See § 6104(b).

### ***Why do social welfare organizations file for recognition?***

Although a social welfare organization is not required to file for recognition, many social welfare organizations seek recognition by filing Form 1024. The IRS lists several reasons why an organization may want to file for recognition, including: “1) public recognition of tax-exempt status; 2) exemption from certain state taxes; 3) nonprofit mailing privileges, etc.” Organizations may also file because: 1) they believe they are required to do so; 2) it creates fewer administrative burdens when they later file administrative returns; and 3) it protects them from being redesignated as a § 527 political organization and thus subject to tax for failing to disclose. See FSA 200046038 (discussing problem of organizations filing Form 990 without having previously filed a Form 1024).

### ***What are the filing obligations of social welfare organizations?***

Social welfare organizations are required to file information returns on Form 990. This form is a public document and contains information about the organization’s activities. The form also requires the organization to disclose donors who contributed \$5,000 or more. The information regarding donors is not included in the public disclosure. See §§ 6104, 6033, Treas. Reg. 1.6104(b)-1(b) (prohibiting disclosure of donor information on Form 990).

### ***If the statutory language in section 501(c)(4) defines a social welfare organization as an organization exclusively engaged in social welfare activities, why is the standard used “primary” and not “exclusively”?***

Treasury Regulation § 1.501(c)(4)-1 provides that a social welfare organization must be organized primarily for a social welfare function. The regulation expands the statutory definition. Specifically, Treasury Regulation § 1.501(c)(4)-1(a)(2)(i) provides “*Promotion of social welfare—(i) In general.* An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general

welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.”

***Why would the regulation use “primary” when the statute uses “exclusively”?***

The goal of the regulatory regime is to provide entity recognition for organizations involved in various activities. If “exclusively” is interpreted literally, there is no organizational category for organizations that primarily engage in social welfare functions but also engage in some electoral activity. Because social welfare organizations were originally treated for tax purposes in a similar manner to political organizations, there was no reason to exclude social welfare organizations from engaging in some political activities.

***What is a political organization?***

A § 527 political organization is an organization “operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures” to influence the “selection, nomination, election, or appointment of any individual to any Federal, State or local public office. . . .” See § 527.

***What is the tax difference between social welfare organizations and political organizations?***

While there are some small differences, the main distinction between political organizations and social welfare organizations is that political organizations are required to disclose contributions and expenditures. If political organizations decline to disclose, they are required to pay tax at the highest corporate rate on the exempt function income. See § 527(j)(1), (j)(3)(A), (j)(3)(B). Exempt function income includes contributions, membership dues, and proceeds from political fundraisers and bingo games. See § 527(c).

***What is the current controversy?***

Because political organizations are required to disclose contributions and expenditures, there is an incentive for organizations to try to organize as social welfare organizations instead of political organizations. Political organizations have as their primary purpose political intervention, whereas social welfare organizations may not have political intervention as their primary purpose. There is concern that organizations are claiming to be social welfare

organizations when they are actually political organizations. The IRS is tasked with determining whether an organization is a social welfare organization or a political organization under the Internal Revenue Code. In addition, § 501(c)(3) organizations (often referred to as churches and charities) are prohibited from intervening in a political campaign. The IRS is also tasked with enforcing this ban.

The current controversy stems from the fact that the IRS used partisan criteria for determining whether to examine applications for recognition as a 501(c)(3) tax-exempt organization or as a § 501(c)(4) social welfare organization. The Inspector General determined that “[t]he IRS used inappropriate criteria that identified for review Tea Party and other organizations applying for tax-exempt status based upon their names or policy positions instead of indications of potential political campaign intervention.”

### ***Why does the IRS need to investigate these organizations?***

When Congress passed the disclosure provisions in § 527, it required disclosure by organizations that intervened in political campaigns. Some organizations that engage in significant political activity have claimed that their activities are not political but are social welfare activities. If organizations primarily engaged in political activity are classified as social welfare organizations, then Congressional intent regarding disclosure will be flouted. Determining the primary purpose of the organization, therefore, requires the IRS to examine the political activities of the organizations seeking status as a social welfare organization and to determine whether those organizations are social welfare organizations or political organizations.

### ***Why would the IRS ask invasive question as part of the application process?***

It is very difficult to determine the primary purpose of an organization. The questions asked of these organizations were clearly designed to try to examine the organizations’ activities. Obviously, an organization seeking status as a social welfare organization that is familiar with the legal rules in this area is not going to state that its primary activity is intervention in a political campaign. If it did so, it would be a § 527 political organization. The IRS needs to examine an organization that applies for recognition under § 501(c)(4) to determine its true purpose. To take an extreme example, if the organization spent \$10,000 on social welfare activities but had 1,000 volunteers who engaged in campaign intervention activities, the primary purpose of the organization would likely be political, despite the fact that it spent more money on social welfare activities. It is understandable how an agent thinking about investigating an organization would ask these types of questions. It is also understandable that in the aggregate these questions were unduly intrusive.

***It is reported that there were delays in considering the applications of social welfare organizations. If the organizations can self-declare, does the delay actually hamper the organization's operations?***

The organization is denied the benefits outlined above by the IRS. In addition, if the organization is afraid that it may be reclassified as a § 527 organization, it may fear that it will be subject to tax on its contributions. The IRS's recognition of an organization's status gives the organization, and those with which it interacts, more certainty regarding its tax status.

***Are contributions to social welfare organizations subject to gift tax?***

Maybe, but not at the moment. Contributions to § 501(c)(3) and § 527 organizations are specifically exempted from gift tax, but there is not a similar exemption for contributions to 501(c)(4) organizations. Many commentators, including me, have argued that social welfare organizations are subject to gift tax. Others argue that the donors are receiving something in exchange for the contribution and the contribution is therefore not a gift. On July 7, 2011, the IRS announced it would not take enforcement action against people who made donations to social welfare organizations. The IRS issued the following statement:

Recently, questions have arisen regarding the applicability of the gift tax to contributions to 501(c)(4) organizations. The Internal Revenue Service has little history to draw from in this area and the limited guidance we previously issued on this matter is almost thirty years old.

While we review the need for additional guidance or legislation, we will not use resources to pursue examinations on this issue. Any future action we take will be prospective and after notice to the public.

As we consider this issue, it is possible that Congress may choose to clearly articulate through legislation the applicability of the gift tax to contributions to 501(c)(4) organizations.

***Are social welfare organizations subject to any disclosure obligations?***

In addition to having to file the Form 990, social welfare organizations are required to comply with Federal Election Law. They must disclose amounts spent on express advocacy and electioneering communication. They do not, however, have to disclose donors unless the

donation to the organization was made “for the purpose of” the election related activity. See Electioneering Communication, 72 FED. REG. 72899, 72911 (Dec. 26, 2007).

***How do these rules apply to 501(c)(3) organizations (primarily churches, charities, and educational institutions)?***

A § 501(c)(3) organization is prohibited from engaging in any activity that constitutes intervention in a political campaign. The IRS uses the same facts and circumstances discussed above for determining whether a § 501(c)(3) organization has intervened in a political campaign. See Rev. Rul. 81-95, Rev. Rul. 2004-6, and I.R.S. Priv. Ltr. Rul. 9652026.