



New Limit & Requirement on 501(c)(4) "Social Welfare" Organizations

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The Internal Revenue Service (IRS) recently released two position papers that affect new, and some existing, social welfare organizations described in section 501(c)(4) of the Internal Revenue Code (Code). Last month the IRS issued guidance (Notice 2016-9) reflecting new Code section 506, added by last December's Protecting Americans from Tax Hikes (PATH) Act. Under this guidance, organizations formed under section 501(c)(4) must now notify the IRS of their existence and intended activities. Last week the IRS issued an internal memorandum, this one under another PATH Act provision that allows any tax-exempt organization (including a 501(c)(4)) to seek a court declaratory judgment overturning an IRS revocation of tax-exempt status (such a declaratory judgment was available only to a Code section 501(c)(3) charitable organization before the PATH Act). In that memorandum (TEGE-04-0216-0003) the IRS stated that, because declaratory judgments are now available to all tax-exempts, the IRS will no longer allow changes to a 501(c)(4) or other entity's tax exemption if the entity fails to qualify for the exemption it originally obtained. Instead, an organization that has had its 501(c)(4) or other exempt status revoked can seek a declaratory judgment reversing the IRS determination, or start anew with an application for exemption under a different Code section.

The Code does not require a 501(c)(4) to apply for and receive an IRS letter confirming its tax-exempt status, though applying is usually a good idea.¹ Many interest groups prefer this form of tax exempt organization because the donor list for a 501(c)(4) is not public record, though it must be disclosed to the IRS on a confidential basis in the organization's Form 990, Return of Organization Exempt From Income Tax.

Now 501(c)(4)s must *notify* the IRS of their existence and intended activities but still are not required to apply for tax-exempt status (although, as mentioned above, applying is usually good practice.) As of now, notification by the 501(c)(4) (and the IRS' acknowledgment of the same) is not the same as the IRS' confirmation of tax-exempt status, and even if the 501(c)(4) has filed (or intends to file) a Form 1024 exemption application it still must notify the IRS under new section 506. However, the IRS through

regulations may coordinate a Form 1024 filing with the required section 506 notification in order to avoid duplication of effort by the organization and by the IRS.

There has been a good deal of controversy about 501(c)(4)s and disclosure regarding their electioneering activities, as evidenced by Congressional hearings examining whether the IRS targeted Tea Party and other organizations and subjected their 1024 applications to additional scrutiny. New section 506, created by the PATH Act, is a step toward addressing these issues. Without section 506, 501(c)(4)s would be able to start operating without notifying the IRS of their existence; engage in electioneering in an election year; and then disappear before filing their first (and often only) Form 990, which would have first alerted the IRS of the organization's existence and activities. The new section 506 notification gives more lead-time to the IRS to monitor the activities of 501(c)(4)s.

New section 506 has particular implications for organizations formed in California (and other states with voter initiatives) to support or oppose a local or statewide ballot measure. California ballot measure organizations are 501(c)(4)s, but because ballot measures usually span only one election cycle these organizations either file as unincorporated associations or incorporate and file a California Form 3500 Exemption Application with the California Franchise Tax Board (and forego filing a Form 1024 with the IRS). With new Code section 506, IRS notification will have to be added to the ballot measure checklist of compliance to-dos.

How does the notification work, and when is it due?

The IRS in Notice 2016-9 said that it is drafting and will issue temporary regulations about how it will implement new section 506, and the statute requires that filers list the organization's name, address, taxpayer identification number, and date and place of formation, and also include a statement of the purpose of the organization. The IRS must send an acknowledgment of receipt within 60 days of the notification. The *statute* gives new organizations only 60 days after they are established to so notify the IRS and gives certain *existing* organizations until June 15, 2016 (180 days after the enactment of the PATH Act) to submit the notification (but see discussion below regarding 501(c)(4)s that have already received a determination letter). However, the IRS in Notice 2016-9 has extended these due dates to at least 60 days from the date that the IRS issues regulations applying new section 506. The IRS may also impose a reasonable fee (whatever that is) for filing the notification.

Neither section 506 nor the Congressional reports describe the detail required for the statement of the purpose of the organization to be contained in the notice, and so taxpayer and their advisors will need to wait for the IRS' interpretation in the temporary regulations. That the statute refers to a statement of the purpose of the organization as opposed to, say, a description of the organization's intended activities implies that Congress intended only a general description of purpose (akin to a mission statement) rather than the detailed description of activities required in a Form 1023 or Form 1024 exemption application. However, the IRS likely will not be satisfied with a vague statement that merely recites general language in the organization's formation documents or recites the wording of section 501(c)(4) (e.g., the purpose of this organization is to promote social welfare). Notice 2016-9 does not give any hint on how the IRS may come down on these questions.

Notice 2016-9 also does not give any hint on whether the IRS might allow (or require) electronic filing of the section 506 notice. The IRS requires that certain other exempt organization applications and reports be filed electronically (for example, Form 1023EZ, Streamlined Application for Recognition of Exemption Under

Section 501(c)(3) of the Internal Revenue Code, or a short-form Form 990-N return) and might similarly allow or require electronic filing of the section 506 notice.

We are currently a 501(c)(4) and have received a determination letter. Do we still have to notify?

No. An existing 501(c)(4) is not required to notify if, on or before the December 18, 2015 enactment date of the PATH Act, that organization either (1) has filed a Form 1024 (whether or not the organization has received an IRS determination letter) or (2) has filed at least one Form 990 return (or, if eligible, a short-form Form 990-EZ or Form 990-N return).

What are the penalties for failure to notify?

The PATH Act amended (1) Code section 6652(c)(4)(A) to impose a penalty on an organization that fails to submit the notification equal to \$20 per day for each day the failure continues, up to a maximum of \$5,000, and (2) Code section 6652(c)(4)(B) to impose a similar penalty on persons who fail to timely submit the notification in response to a written request by the IRS.

How can Nossaman help?

Nossaman attorneys have extensive experience in forming 501(c)(3)s, 501(c)(4)s and PACs; applying for tax-exempt or other special status at the federal, state and local level; advising clients on affiliations between these types of organizations; and guiding clients through the complex lobbying and electioneering restrictions on these organizations at the federal, state and local levels. Please contact us if you have questions about new section 506 or about 501(c)(4)s in general, or how you might best describe your organization's purpose and otherwise complete your notice once the IRS issues its temporary regulations implementing section 506.

¹ (A 501(c)(4) applies via Form 1024, Application for Recognition of Exemption Under Section 501(a). The Code does require most 501(c)(3)s to apply for and receive IRS confirmation of their tax-exempt status (via Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code or (if the organization is eligible) Form 1023EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code).