

## Background on Nonprofit, Tax-Exempt Section 501(c)(4) Organizations

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Some background and explanation regarding organizations described in section 501(c)(4) of the Internal Revenue Code may be useful to those interested in election law and the current controversy regarding American Issues Project, Inc., since being described as such an organization is one of the requirements for the qualified nonprofit corporation exemption from the prohibitions on making independent expenditures and electioneering communications.

### **Forming the Nonprofit Corporation**

First, as a preliminary matter, under the Internal Revenue Code, exempt organizations do not have to form as corporations; they can be trusts or unincorporated associations. Many, perhaps most, do form as corporations.

The law of the state of incorporation generally governs internal organizational matters of nonprofit corporations. Although most choose as their state of incorporation the state in which the organization intends to conduct its activities, such is not required as a matter of law. Nonprofit organizations can incorporate in another state and then apply for authority to do business in their home jurisdiction as a registered foreign corporation, as many for-profit corporations do. [\*See Garry Jenkins, Incorporation Choice, Uniformity, and the Reform of Nonprofit Law, 41 GA. L. REV. 1117 \(2007\).\*](#)

Most states have separate nonprofit corporate statutes and permit easy and quick formation of nonprofit corporations. Such is not always the case. In New York, for example, the need for incorporators of nonprofit corporations with certain specified purposes to obtain waivers or consents by specified authorities means incorporation can take some time. *See N.Y. Not-For-Profit Corp. Law. Sec. 404.* Delaware, in contrast, has no separate nonprofit corporate statute. Moreover, incorporation in Delaware can be accomplished very quickly.

Note that forming a nonprofit corporation is a matter of state corporate law, not federal tax law. Compliance with state corporate laws thus can be an issue of significance apart from compliance with federal tax law. (Issues of state tax exemption arise as well, but since they differ considerably from state to state, I do not address them here.)

### **Political Campaign Intervention by Section 501(c)(4) Organizations**

Section 501(c)(4), one of the 28 categories of tax-exempt organizations listed in section 501(c) of the Internal Revenue Code, provides exemption for organizations that are “civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.” Treasury regulation section 1.501(c)(4)-1(a)(2)(i) explains further that an organization is operated 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” and in bringing about “civic betterments and social improvements.” Examples of such activities would include educational activities, nonpartisan analysis study, or research, and advocating changes in the law – that is, lobbying.

An organization that engaged in activities other than lobbying that were “promoting the common good and general welfare” and bringing about “civic betterments and social improvements” could qualify for exemption under section 501(c)(3) instead of section 501(c)(4) and thus be eligible to receive tax-deductible contributions. (Donations to section 501(c)(4) organizations are not tax-deductible.) Unlike section 501(c)(3) organizations, however, section 501(c)(4) organizations can engage in unlimited lobbying and, The ability to engage in such advocacy is an important reason that organizations choose exemption under section 501(c)(4) instead of section 501(c)(3). (Paired 501(c)(3) and 501(c)(4) organizations are also common.)

In addition, and particularly important for purposes of the qualified nonprofit corporation exception, section 501(c)(4) organizations, unlike section 501(c)(3) organizations are not prohibited from intervening in political campaigns. However, Treasury regulation sec. 1.501(c)(4)-1(a)(2)(ii) states, “The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns of behalf or in opposition to any candidate for public office.” The IRS has also made clear that so long as a section 501(c)(4) organization is primarily engaged in activities that further its social welfare purposes, “its lawful participation or intervention in political campaigns on behalf or in opposition to candidates for public office will not adversely affect its exempt status under section 501(c)(4) of the Code,” although such expenditures may be subject to tax under section 527. Revenue Ruling 81-95. Thus, Section 501(c)(4) organizations cannot engage in unlimited political campaign intervention. They must take care to ensure that engaging in such activities does not become their primary focus.

In an article in a 1994 Continuing Professional Education Text written for IRS agents but used by exempt organization practitioners generally, the IRS took the position that whether an organization is “primarily engaged in promoting social welfare” is a facts and circumstances determination that depends on such factors as

the amounts of funds received from and devoted to particular activities; other resources used in conducting such activities, such as building and equipment; the time devoted to activities (by volunteers as well as employees); and the manner in which the organization’s activities are conducted; and the purposes furthered by various activities.

Raymond Chick and Amy Henchey, Political Organizations and IRC 501(c)(4) 1994 Exempt Organizations Continuing Education Technical Instruction Program 191.

The same article suggested that “participation in a political campaign” is also a facts and circumstances determination and is interpreted for purposes of section 501(c)(4) in the same way as it is for section 501(c)(3). That is, for example, the same criteria would apply to distinguish educational from political activities in both context.

Others, however, suggest a bright line rule. A popular textbook notes: “A good rule of thumb is to limit electioneering to less than 50 percent of an organization’s total activities.” James J. Fishman and Stephen Schwarz, *Nonprofit Organizations: Cases and Materials* (3<sup>rd</sup> ed.) 556. Many exempt organization practitioners have expressed a belief that the IRS will be satisfied if this 50% test is done based on expenditures per each fiscal year.

Section 501(c)(4) organizations are required to make available to the public their annual information returns, Form 990, which includes detailed information about their expenditures, including political intervention expenditures, and other aspects of their operations. The most recently available Forms 990 for most exempt organizations are available at no charge to the public at [www.Guidestar.org](http://www.Guidestar.org).

The IRS has recently redesigned the Form 990 and released the instructions for the new Form 990. The [new form](#) will require increased disclosure in many areas.

### **Obtaining Exempt Status as a Section 501(c)(4) Organization**

The Internal Revenue Code requires that organizations seeking exemption under section 501(c)(3) notify the IRS that they are applying for exemption and receive a favorable determination of their exempt status. Section 501(c)(4) organizations have no similar obligation to file for exemption and do not need to give donors the certainty that donations will be deductible, but as a practical matter, section 501(c)(4) organizations generally seek the certainty of receiving an IRS determination letter of their exempt status.

Section 501(c)(4) organizations apply for tax-exempt status by filing [Form 1024](#), as required by the [instructions](#) for this category of organization. Filling out the form, undergoing IRS review, and receiving exemption is a time-consuming task, often taking many weeks or even months.

In some cases, it takes years. The Christian Coalition, which was established in 1990, has a dispute with the IRS for 15 years over section 501(c)(4) status for one of its organizations. According to reports, the exemption application was denied because of the coalition’s extensive political activities. In response, the organization split into two groups, and one of the groups assumed the already secured 501(c)(4) classification of the Christian Coalition of Texas. The other group, Christian Coalition International, received

its exemption in 2005, after submitting an application that included criteria for voter guides that would qualify as nonpartisan and could be distributed in churches.

Exempt organization practitioners have told me that it is not uncommon to make use of an already existing inactive 501(c)(4) organization – one that already has received its exemption determination letter from the IRS - to get new organizations up and running quickly. Indeed, practitioners tell me they are regularly asked if they might be interested in buying an organization that has received exemption. Using an existing organization, moreover, also avoids the scrutiny to which an application for exemption is subject by the IRS. Some practitioners do find this practice uncomfortable or even unethical, at least if they are asked to pay for the use of existing exempt organizations.

If an existing 501(c)(4) organization changes its name, character or operation, it must report these changes to the IRS. To do so is easy. Under current requirements, when an organization that has already received exemption from the IRS makes such material changes, all that is required is for it to notify the IRS of them changes on its next Form 990.

Exempt organizations are subject to very low audit rates; according to IRS Statistics of Income data, in Calendar Year 2006, for example, 867,696 Forms 990 were processed and only 3,850 of them were examined. Thus, failure to make an adequate - or any disclosure - of material change on the Form 990 is unlikely to be detected. If they are detected on audit, some changes, such as too much political campaign intervention, can, be the basis for revocation of exempt status.

Taxpayers do not have the option of supplementing IRS enforcement efforts by suing organizations to challenge their exempt status. They lack standing to do so. *See In re United States Catholic Conference*, 885 F.2d 1020 (1989), *cert. denied* 495 U.S. 918 (1990). Taxpayers can, however, file a [complaint](#) with the IRS if they believe that the activities or operations of a tax-exempt organization are inconsistent with its tax-exempt status.

### **Applying These Rules to AIP**

NPR has made available documents showing that AIP was first incorporated as a Delaware corporation in May 2007 under the name Citizens for the Republic. The metamorphosis of Citizens for the Republic into AIP raises both corporate and tax-exempt issues. The directors of Citizens for the Republic, according to a Delaware Franchise Tax Report, were Paul Erickson, Stephen Moore, and Richard Sharp, all of Sioux Falls, South Dakota. Citizens for the Republic changed its name to Avenger, Inc. in March 2008, and changed its name to American Issues Project, Inc. in August 2008. According to NPR, Citizens for the Republic received exemption as a section 501(c)(4) organization. It reports that Mr. Erickson has stated that Avenger, Inc. was just a placeholder names and that Citizens for the Republic has nothing to do with AIP, that AIP has completely separate leadership and simply used the corporate shell of Citizens for the Republic after it disbanded.

The organizations do share some common goals and purposes. According to the NPR report, Citizens for the Republic was formed to push a conservative, free-market issues agenda. AIP's website describes itself as "having been founded to champion the conservative values that have made the United States of America a blessed nation: a smaller government, a strong and ready national defense, lower taxes, and a government that encourages entrepreneurship and new job creation in America."

Making specific corporate changes requires compliance with applicable corporate law. Changing the corporate name and appointing new corporate directors requires following the procedures established not only by the applicable corporate law but also by bylaws of Citizens for the Republic/Avenger, Inc. The certificate changing the name of the corporation from Avenger, Inc. to American Issues Project, Inc is signed by Paul Erickson as President, the very person who is reported to have said that Citizens for the Republic had been disbanded, and thus suggests that, despite his statement, the entity had not in fact completely disbanded and that the formalities were likely observed. However, further information, including the bylaws of Citizens for the Republic/Avenger, Inc., is needed to be sure that such is the case and the all necessary approvals by the board of directors, etc. were obtained.

Establishing AIP as a continuation of Citizens for the Republic avoided the sometimes lengthy process of applying for and receiving federal tax-exemption. AIP, as the continuation of Citizens for the Republic, must, as a section 501(c)(4) organization, be engaged primarily in activities that promote social welfare and, as noted above, the applicable Treasury regulations exclude intervention in political campaigns as activities that promote social welfare. We do not know whether Citizens for the Republic, when it applied for exemption, indicated that it planned to engage in any campaign intervention. Section 501(c)(4) organizations, like other exempt organizations, must make their applications for exemption available upon request, but these applications are not easily available on a central website in the way that the Form 990 annual information returns are. (Bob Bauer, General Counsel to Obama for America, in his [response](#) to [Allison Hayward](#) indicates that he has requested this documentation from AIP.) Neither is the Form 990 for Citizens for the Republic available at [www.Guidestar.org](http://www.Guidestar.org), although the organization is listed on the site. The absence is not surprising. Although its fiscal year is not clear from the documents available, it seems likely that Citizens for the Republic (or Avenger, Inc. upon the name change in March 2008) received an automatic extension for filing its first Form 990 and perhaps a further extension as well, and there is a delay before Guidestar posts the forms that it receives. Citizens for the Republic/Avenger, Inc. might also have had gross revenues below the minimum required for filing a Form 990 (annual gross receipts that normally equal or exceed \$25,000).

Far more interesting will be the first Form 990 for AIP itself. While AIP has stated that the majority of its annual expenditures will not be political expenditures, the Form 990 will give hard data to back up these claims. Whether its level of political as compared to other kinds of expenditures will resolve the question of its being engagement primarily in social welfare is not free from doubt, however. As noted above, many exempt organization practitioners believe that it is adequate to show that a majority of

expenditures over an entire fiscal year are devoted to social welfare rather than political campaign intervention. The Form 990 should also indicate whether the change from Citizens from the Republic/ Avenger, Inc. to AIP made a change not only in the name, but also a material change in the character and operation of the organization.

### **Concluding Thoughts**

Use of a preexisting but inactive exempt organizations, I have learned, is not uncommon. Current procedures do not clearly forbid or seem even to limit this practice, although some question it. Whether administrative procedures should permit such avoidance of the application process, whether there should be a point at which changes are so material, the connection between the old officers and operations and the new so attenuated that a new application should be required are questions that those of us who work in this area must consider and discuss with each other and with officials at IRS and Treasury. I have begun this discussion, with mixed results. (One participant on one of my listservs called me a communist witch for even asking the question.)

Neither is there precedential guidance on how and when to measure whether a section's 501(c)(4) is primarily engaged in promoting social welfare. A bright-line test based on expenditures per fiscal year has a parallel in the election that section 501(h) of the Internal Revenue Code offers to section 501(c)(3) organizations charities regarding the extent to which they can engage in lobbying. This detailed expenditure test, however, was enacted by Congress. Moreover, those that do not make the election must live with a facts and circumstances test.

None of these questions will be answered soon, certainly not before the election.