Civic Leagues, Social Welfare Organizations, and Local Associations of Employees--IRC Section 501(c)(4)

Introduction, Sections A, B, C, and D

Objectives

Introduction

At the end of this lesson the students will be able to:

- Identify the general types of IRC section 501(c)(4) organizations
- Apply the various requirements which an IRC section 501(c)(4) organization must meet to qualify for tax exempt status

Section A

At the end of this section the students will be able to:

- Identify the two key elements that organizations seeking exemption under IRC section 501(c)(4) must demonstrate
- Define "social welfare"
- Define "community benefit"
- Determine whether a civic league or social welfare organization qualifies for exemption
- Explain how organizations applying for exemption under IRC section 501(c)(4) may qualify for exemption under other Code sections
- Identify circumstances which make contributions to 501(c)(4) organizations deductible

Section B

At the end of this section the students will be able to:
• List the requirements for an organization to qualify for exemption as a local association of employees under IRC 501(c)(4)

• Define “local” as used in IRC 501(c)(4)

• Determine whether a local association of employees qualifies for exemption

Section C

At the end of this section the students will be able to:

• Describe the three criteria of Rev. Rul. 74-99 an organization seeking exemption as a homeowners’ association under IRC section 501(c)(4) must meet

• Explain the three requirements homeowners’ associations must satisfy to qualify for tax relief under IRC section 528

Section D

At the end of this section the students will be able to:

• Determine whether activities are related to an exempt purpose and the effect on a request for exemption

• Identify activities conducted by an organization that may cause tax to be imposed on the income from that activity

Assistant(s)

None

Estimated Time

3 hours

Space Required

3-2
Classroom

Methods of Instruction
Reading
Lecture
Class Discussion
Class Exercise

Student Materials
Coursebook

Training Aids
Lesson Exhibits
Class Exercise

Equipment and Supplies
Whiteboard
Flipchart

Instructor References
Instructor Guide Class Exercise

Student References
Coursebook
Introduction

Explain that Lesson 2 is broken down into four different sections (A through D), to emphasize the special requirements necessary for specific types of organizations requesting exemption under IRC section 501(c)(4).

Stress that the key element of most IRC section 501(c)(4) organizations is to show that the activities promote the social welfare of the community in general.

One exception to this general rule is a “Local Association of Employees.”

Objectives

Have the objectives displayed on flipchart.
Basic Information

Emphasize that caution is necessary in reviewing the primary activities of an IRC section 501(c)(4) organization since they might also qualify for exemption under other subsections.

Stress that students must establish the primary activity to determine which subsection is applicable to an organization.

Be aware of issues involving inurement applicable to IRC section 501(c)(4) that would deny exemption under this subsection.

Point out that an IRC section 501(c)(4) organization does not have required organizational language like an IRC section 501(c)(3) organization.

Contributions to an IRC section 501(c)(4) organization are generally not deductible.

Qualifying Purposes

Review the general categories that qualify under this subsection, and indicate that while veterans’ organizations can qualify, they will be covered in detail in subsequent training.

Point out that an IRC section 501(c)(4) organization is required to meet an operational test to be exempt under this section.
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Section A
Civic Leagues and Social Welfare Organizations

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<th>Notes to Instructor</th>
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Overview

An IRC section 501(c)(4) organization must show that its primary purpose is to 1) Promote social welfare, and 2) Benefit the community in general.

Point out this is different from an IRC section 501(c)(3) organization that must show their activities are "exclusively" for a (c)(3) purpose.

Inurement and private benefit are still potential issues that require development.

Objectives

Have the objectives displayed on flipchart.

Key Element 1: Promote Social Welfare

Since this area may be very subjective and open to interpretation, explain the legal analysis as established by the courts.

Point out that there is considerable overlap between "social welfare" and "charity" so we do not always encounter clear-cut determinations.

After defining an "action organization," explain that they typically do not qualify for exemption under IRC section 501(c)(3), but rather IRC section 501(c)(4).
Key Element 2: Benefit the Community in General

Explain that the proposed activities must be broad enough in scope that the benefits provided do not go to a select group of individuals.

Describe the concept of "community benefit" as established in Rev. Rul. 74-99. Tell the students that this concept will resurface in the section on homeowners' associations, as well.

Revenue Rulings

Have the students read about the favorable and unfavorable revenue rulings as they relate to the two key elements, promoting social welfare and benefiting the community in general.

Compare and contrast the various scenarios and make sure the students understand the rationales for each ruling.

"Exclusively" Means Primary

Distinguish "exclusively" as applied to an IRC section 501(c)(3) application from "exclusively" as applied to an IRC section 501(c)(4) application.

"Exclusively" only means "primary" for (c)(4) and "primary" is generally understood to mean 51%.
Contributions Deductible?

After explaining the deductibility concepts, explain that such organizations typically apply for IRC section 501(c)(3) instead.

While it would not be incorrect to grant (c)(4) exemption with deductibility to a volunteer fire department, we would generally extend (c)(3) exemption instead of (c)(4).

Such an organization may settle for (c)(4) exemption with deductibility, anyway, if they do not wish to fill out a whole new application, amend their organizing document, etc.

Qualification Under Other Code Sections

Give the students plenty of time to review the tables in the text comparing and contrasting the different subsections.

Explain that the other subsections will be covered in detail in subsequent lessons, so do not be concerned if they do not fully grasp the differences.

Advise them to refer back to these tables after reviewing the other subsections for reinforcement.

Stress that the garden club Rev. Rul. 66-179 is often cited in situations involving questionable subsections.

Qualified Under 501(c)(3) and 501(c)(4)

Mention that students may occasionally encounter
old housing programs that request (c)(4) because their original grants require them to be exempt under that subsection.

Note to Instructor – The previous sub-lesson entitled “Organizations Supported by Government Grants” has been removed in its entirety. This section briefly covers the general concepts from that sub-lesson.

Modification from (c)(3) to (c)(4)

Point out that the presence of legislative or political activities is one of the most common reasons we suggest (c)(4) instead of (c)(3).

This is true even if the other purposes and activities are in line with (c)(3).

Not Qualified for (c)(3) or (c)(4)

Make sure students understand the prohibitions now before encountering these situations on the job, as it is very bad publicity to recommend a change in subsection, then later realize we gave the organization bad advice and led them in the wrong direction (and potentially jeopardize a proposed denial).

Inurement

Emphasize that inurement is now an act that will bar exemption under (c)(4) in the same manner as applied to a (c)(3).

Stress the need to be alert for activities and financial transactions that might be indicators of inurement.

Summary

5-A-4
Section B
Local Associations of Employees

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<td><strong>Overview</strong></td>
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<tr>
<td>A local association of employees has a different set of standards to meet, which does not exactly apply the standards of “social welfare for the benefit of the community” in general.</td>
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<td>Tell the students that these types of applications are few and far between.</td>
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<td><strong>Objectives</strong></td>
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**Exemption Requirements**

- Stress that the employees must be those of a single employer.
- Define the term “local” as it applies to this type of association.
- Explain that the students will learn about local benevolent life insurance associations described in IRC section 501(c)(12) in an upcoming lesson.
- Review favorable examples of a qualifying association.

**Summary**
Section C
Homeowners’ Associations

Objectives

Have the objectives displayed on flipchart.

Reviewing the Application

The most important factor here will be to determine that activities are for community benefit and not the private benefit of homeowners.

Review the three criteria a homeowners association must meet.

Hand out a copy of Rev. Rul. 74-99, or else have the students locate it on their laptops electronically.

Stress that homeowners associations do not require a certain number of members. However, their burden of proof in establishing community benefit increases with fewer members.

When trying to determine whether the association restricts access to its facilities, focus on whether the development is a “gated community.”

IRC Section 528

Discuss the effects of IRC section 528, pointing...
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<td>Out these are relief provisions to prevent homeowners associations from taxation of all receipts as a corporation.</td>
<td>Hand out Form 1120-H, or else have the students locate it on their laptops electronically</td>
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**Summary**

5-C-2
## Section D
### Activities Not Related to Exempt Purpose

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### Activities Not Related To Exempt Purpose

Stress the review of activities of all other IRC section 501(c) organizations is different from a review of the activities of a (c)(3) organization.

Remind the students of the difference between “exclusively” in (c)(3) and “primarily” in (c)(4).

Remind them that 51% of the activities of a (c)(4) must be directly related to their exempt purpose.

### Political Activities

The prohibition of political activities in (c)(3) does not apply to (c)(4) as long as conducting political activities is not the primary activity of the (c)(4).
## Legislative Activities

The conduct of legislative activities may be substantial if *germane* to a (c)(4) purpose.

Briefly go over the term "*germane*" to make sure the students comprehend its meaning.

## Social Activities

The conduct of social activities is not an exempt purpose of a (c)(4) organization.

Any social activities for members may be substantial so long as they are not the primary activity.

If the conduct of social activities is a primary purpose of the organization, exemption would not be granted under (c)(4) but the organization might qualify under (c)(7).

Volunteer fire departments may conduct substantial social activities, as they generally relieve stress and contribute to the social welfare of the community in general.
Business Activities

A (c)(4) organization may conduct business with the general public to finance their programs, however the conduct of such activities is not related to their exempt purpose.

If the conduct of business with the general public is the primary purpose of the organization, exemption under (c)(4) would be denied.

Alert the students to view the activities on the Form 1024 to determine if an activity is a business or promotes social welfare and to determine if the activity is the type of business conducted by a nonprofit organization.

Discuss the need to determine how the business income of the organization is used and under what circumstances the use of that income could result in a denial of exemption under (c)(4).
Insurance Activities

Some (c)(4) organizations may offer various types of insurance programs to members, primarily health insurance.

Tell students the way in which insurance benefits may be provided.

Providing insurance benefit to members is not an exempt purpose and, if it is the primary activity, exemption would be denied.

Tax on Activities Not Related To Exempt Purpose

Stress the importance of separating activities related to an exempt purpose from activities unrelated to an exempt purpose.

Refer back to Lesson 16 in Unit 1a which covered unrelated business activities in more detail.

Summary

Class Exercise

Have students complete the class exercise at the end of the lesson and lead a class discussion on the questions and answers. The exercise is cumulative and covers lessons 2A through 2D.
Instructor Guide Class Exercise
IRC section 501(c)(4)

1. An IRC section 501(c)(4) organization does **not** have to meet the organizational requirement that must be met by an IRC section 501(c)(3) organization.

   True  False

   **Answer:** True. There is no requirement for a specifically-worded purpose clause or dissolution clause in the organizing document of an IRC section 501(c)(4) organization.

2. The inurement of net earnings and providing benefits to individuals and shareholders is **not** prohibited for an IRC section 501(c)(4) organization, as it is for one exempt under IRC section 501(c)(3).

   True  False

   **Answer:** False. The Taxpayer Bill of Rights 2 (enacted July 30, 1996), prohibits inurement and permitted an intermediate sanctions tax to be assessed against an organization exempt under IRC section 501(c)(4) when there were excess benefits transactions with corporate officials.

3. What are the two key elements an organization seeking exemption under IRC section 501(c)(4) must have present?

   **Answer:**
   
   1. **Promoting social welfare**
   
   2. **Providing benefits to the community in general**
4. IRC section 501(c)(4) requires that the exempt activities of the organization must be exclusively for the conduct of social welfare activities for the benefit of the community in general. In the context of IRC section 501(c)(4), exclusively means:

a) Predominately  
b) Substantially  
c) A significant part of  
d) Primarily

Answer: (d) The term exclusively as used in IRC section 501(c)(4) means “primarily.” The exempt activities must be more than 50% of all activities before exemption under this subsection will be granted.

5. Which of the following would prohibit a local association of employees from obtaining exemption under IRC section 501(c)(4)?

a) The employees are the employees of a single employer  
b) The association is local in nature  
c) The employees of the association are located throughout the country  
d) The net income of the association is used to provide recreational activities for the employees.

Answer: (c) A local association of employees must be employees of a single employer confined to a particular community, place, or district, disregarding political subdivisions. The association would not be local if the employees were located throughout the country.

6. Rev. Rul. 74-99 established the criteria a homeowners association must meet in order to qualify under IRC section 501(c)(4).

Which of the following, if any, would prevent a homeowners association from being granted tax-exempt status under this subsection?

a) The association bears a relationship to a governmental area  
b) The association provides for the maintenance of members’ residences  
c) Any common areas of the association are open to the general public  
d) All of the above are permissible activities under Rev. Rul 74-99.

Answer: (b) Providing maintenance of members’ residences confers a private benefit that would prohibit granting exemption under IRC section 501(c)(4).
7. A homeowners association that fails to qualify for exemption under IRC section 501(c)(4) would be taxed in the same manner as any other taxable corporation.

   True  False

   Answer: False. IRC section 528 excludes from taxation all exempt function income of a qualifying homeowners association.

8. Contributions to organizations exempt under IRC section 501(c)(4) may be deductible in certain circumstances.

   True  False

   Answer: True. IRC section 170(c)(1) (and Rev. Rul. 71-47) allow a charitable deduction for contributions made to an IRC section 501(c)(4) organization if the contributions are deemed to be for the use of a political subdivision for exclusively public purposes. A volunteer fire department, for example.