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Examining the Landscape of Section 501(c)(4) Social Welfare Organizations

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Ellen P. Aprill*

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I. Introduction

After the Supreme Court's 2010 decision in *Citizens United* permitting campaign contributions from corporations¹ and the IRS's 2013 admission of mistreating applications for exemption from a number of conservative groups by engaging in overly zealous review,² discussion regarding social welfare organizations exempt under section 501(c)(4) of the Internal Revenue Code³ has centered on their growing role as the source of so-called dark money in electoral campaigns.⁴ In their influential reference book, Hill and Mancino assert: "Section 501(c)(4) is now most commonly used for advocacy organizations engaged in a range of lobbying and campaign activities."⁵ Bruce Hopkins in his guidebook concurs: "The principal type or organization that is tax-exempt by reason of this category of exemption is one that is advocacy-oriented—in the sense of focus on community, state and/or national policymaking, including lobbying."⁶ That is, although section 501(c)(4) organizations have long had the ability to engage in advocacy, this role has taken on increased prominence in public discourse.

The ability of section 501(c)(4) social welfare organizations to engage in lobbying and campaign intervention distinguishes them from section 501(c)(3) exempt organizations, which we generally refer to as charities.⁷ Social welfare organizations can lobby without limit and, of

¹ *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010).

² A 2013 report from the Treasury Inspector General for Tax Administration concluded that "the 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."

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW, Highlights (May 14, 2013), available at <https://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf>. See SENATE FIN. COMM., THE INTERNAL REVENUE SERVICE'S PROCESSING OF 501(c)(3) AND 501(c)(4) APPLICATION FOR TAX-EXEMPT STATUS SUBMITTED BY "POLITICAL ADVOCACY" ORGANIZATIONS FROM 2010-2013, S. REP. NO. 114-119 (2016), <https://www.congress.gov/congressional-report/114th-congress/senate-report/119>, Lily Kahng, *The IRS Tea Party Controversy and Administrative Discretion*, 99 CORNELL L. REV. ONLINE 41 (2013), available at <http://cornelllawreview.org/files/2013/09/99CLRO411.pdf>.

³ I.R.C. § 501(c)(4) (2018).

⁴ Dark money refers to money from groups that are able to influence elections without disclosing the source of their funds. See Center for Responsive Politics, OpenSecrets.org, *Dark Money*, available at <https://www.opensecrets.org/dark-money/>. See generally JANE MEYER, DARK MONEY (2016).

⁵ FRANCES R. HILL & DOUGLAS M. MANCINO, TAXATION OF EXEMPT ORGANIZATIONS, ¶ 13.01 (2002).

⁶ BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 389 (9th ed. 2007).

⁷ Cf. I.R.C. § 501(c)(3)(2018) and § 501(c)(4) (2018).

particular importance, can engage in campaign intervention—supporting or opposing candidates for public office—so long as such activity is not their primary activity.⁸ Applicable tax regulations require that social welfare organizations operate “primarily for the promotion of social welfare,”⁹ and social welfare does not include campaign intervention.¹⁰ The IRS, however, has never officially defined what primary activity means.¹¹ This failure has left the upper limits on the amount of permitted campaign intervention by section 501(c)(4) organizations unclear, and many advisors to organizations take the position that campaign intervention can constitute up to 49% of a social welfare organization’s activities.¹² Such freedom to electioneer comes with a tax price: Donations to social welfare organizations are not deductible as charitable contributions.¹³ In contrast, organizations exempt as charities under section 501(c)(3) can lobby only to a limited extent and are prohibited completely from engaging in campaign intervention.¹⁴ Donations to them, however, are deductible from income tax as charitable contributions.¹⁵

While the role of section 501(c)(4) organizations in lobbying and campaigns activities is of the utmost policy importance, as other symposium papers discuss in detail,¹⁶ recent empirical work, particularly a 2016 study from the Urban Institute, disputes the prominence of political activity among section 501(c)(4) organizations. This 2016 study found the same result

⁸ Treas. Reg. § 1.501(c)(4)-1(a)(2).

⁹ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

¹⁰ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

¹¹ See Ellen P. Aprill, *A Case Study of Legislation vs. Regulation: Defining Political Campaign Intervention under Federal Tax Law*, 63 Duke L.J. 1635, 1636-37 (2014).

¹² See Campaign Legal Center, IRS: Reform Groups Call on IRS To Clarify 49 Percent Approach (April 3, 2015) *available at* <http://www.campaignlegalcenter.org/news/press-releases/irs-reform-groups-call-irs-clarify-49-percent-approach>.

¹³ Internal Revenue Service, Donations to Section 501(c)(4) Organizations, *available at* <https://www.irs.gov/charities-non-profits/other-non-profits/donations-to-section-501c4-organizations>.

¹⁴ Section 501(c)(3) requires that to be exempt under that subsection, “no substantial part” of its activities consist of attempting “to influence legislation” and that it “not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.” I.R.C. § 501(c)(3) (2018).

¹⁵ I.R.C. § 170(c)(2) (2018).

¹⁶ Cross ref to symposium papers.

whether examining the universe of section 501(c)(4) organizations as a whole or only those organized since *Citizens United*.¹⁷ Jeremy Koulish, the author of the Urban Institute study, emphasizes that “the rules governing political activity are of little to no consequences for most 501(c)(4) organization because they are not involved in advocacy activities, let alone electoral politics.”¹⁸ Another study concludes that “a large proportion of 501(c)(4) organizations are not politically or electorally active. Among those that are, the amount of money spent on influencing elections is very small.”¹⁹

In short, to focus only on the political activities of section 501(c)(4) organizations misrepresents and misunderstands the role and impact of the subsector. As the IRS observed more than twenty-five years ago, “IRC 501(c)(4) remains in some degree a catch-all for presumptively beneficial non-profit organizations that resist classification under the other exempting provisions of the Code.”²⁰ The 2016 Urban Institute study portrays section 501(c)(4) as “a sort of dumping ground for organizations otherwise difficult to categorize.”²¹ The author of the study characterizes the subsector as containing a “dizzying array of organizational missions, structures, sizes, and activities.”²²

John Simon, Harvey Dale and Laura Chisolm have written about the “border control” functions applicable to charitable organizations, in particular analyzing the campaign intervention prohibition and the unrelated business income tax as “fences – or at least guard rails” to guard against charitable incursion, respectively, into governmental and commercial spheres.²³ That is, border control rules work to ensure that exempt organizations carry out their exempt functions and do not stray into other spheres. I suggest that section 501(c)(4) as a whole carries

¹⁷ JEREMY KOULISH, RESEARCH REPORT: FROM CAMPS TO CAMPAIGN FUNDS: THE HISTORY, ANATOMY, AND ACTIVITIES OF SECTION 501(c)(4) ORGANIZATIONS, Urban Institute, Jan. 28, 2016 [hereinafter Koulish]. The findings of the study are discussed in detail at *infra* Part IV.

¹⁸ Koulish, *supra* note 17, at 1.

¹⁹ Jeff Krehely & Kendall Gollday, *The Scope and Activities of 501(c)(4) Welfare Organizations: Fact versus Fantasy*, at 24, prepared for the 2001 ARNOVA Research Conference (on file with author and cited with permission). This study, admittedly, predates *Citizens United*.

²⁰ Internal Revenue Service, Social Welfare: What Does It Mean? How Much Private Benefit Is Permissible?, 1981 Continuing Professional Education Text, *available at*, <https://www.irs.gov/pub/irs-tege/eotopicg81.pdf> [hereinafter 1981 CPE Text]. The chapter is not paginated.

²¹ Koulish, *supra* note 17, at 4.

²² *Id.* at 3-4.

²³ John Simon, Harvey Dale & Laura Chisolm, *The Federal Tax Treatment of Charitable Organizations*, in *THE NON-PROFIT SECTOR* 267, 284-92 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006).

out this border control function by providing a home for entities that are almost but not quite eligible under section 501(c)(3) or other provisions of 501(c).²⁴ By doing so, it has prevented pressure on and distortions of these other provisions. Rather than a dumping ground, I would call the subsector a messy no man's land or, perhaps, a land with fences that are, as described below, full of holes.

Mixing and pushing this metaphor further, I acknowledge that this no man's land is something like the famous optical illusion that can be seen either as a vase or a pair of profiles. Rather than protecting the integrity of section 501(c)(3), the uncertain boundaries of section 501(c)(4) can also operate in the opposite direction—undermining the limits applicable to charity and thereby creating a dangerous no man's land for the exempt sector as a whole. Use of section 501(c)(4) organizations as grantmaking entities free of the restrictions imposed on private foundations,²⁵ which I discuss briefly below and which is the subject of another symposium paper,²⁶ offers the best example of such deployment of section 501(c)(4). Developments in the law over the past decades, such as changes in election law, have also undermined this border control function of section 501(c)(4) in other areas, also discussed below.²⁷ These changes have opened the door for new, and possibly questionable, uses of section 501(c)(4) organizations.

Moreover, provisions enacted as part of the 2017 tax legislation, in particular a substantially increased standard deduction and limits on the itemized deduction for state and local taxes, may well spur donations to section 501(c)(4) instead of section 501(c)(3) organizations.²⁸

²⁴ Earlier NCPL major conferences have examined the boundaries of section 501(c)(3) and the role of various doctrines in corralling section 501(c)(3). See NAT'L CTR. ON PHILANTHROPY AND THE LAW, *Elasticity of the Borders: What Is and Isn't Charitable* (2015), <http://ncpl.law.nyu.edu/wp-content/uploads/2014/07/2015-Formal-Agenda.pdf>; NAT'L CTR. ON PHILANTHROPY AND THE LAW, *Border Control: Charitable Status despite Inurement or Private Benefit* (2011), http://ncpl.law.nyu.edu/zz_conferences/documents/2011Agenda.pdf. Here I examine an entire subsection of 501(c) as an exercise in border control.

²⁵ A private foundation is a particular type of section 501(c)(3) organization. Unlike the entities known as public charities, funding for a private foundation typically comes from a single family, individual or corporation. See I.R.C. § 509 (2018). Private foundations generally support public charities through grants, rather than engaging directly in charitable activities. See Foundation Source, *What Is a Private Foundation*, available at <https://www.foundation-source.com/learn-about-foundations/what-is-a-private-foundation/>. Private foundations are subject to a number of onerous excise taxes that operate as prohibitions on certain activities, such as self-dealing, excessive business holdings, imprudent investments, and lobbying. See I.R.C. §§ 4941-4945 (2018).

²⁶ David M. Miller [to be completed with symposium citation].

²⁷ See text at *infra* notes 179-183.

²⁸ See *infra* Part IX.

A large number of taxpayers will no longer itemize deductions, including the charitable contribution deduction. Without a tax incentive for charitable contributions, some of these taxpayers may choose instead to make nondeductible contributions to section 501(c)(4) organizations because of their greater flexibility, including the ability to engage in political activities. As a result, the role of section 501(c)(4) in our tax system and its relationship to section 501(c)(3) may well differ considerably going forward.

The no man's zone of section 501(c)(4) has also witnessed a variety of skirmishes in the past. Both grant of exemption under section 501(c)(4) and denial of such exemption have prompted Congress to enact various pieces of legislation to clarify rules around exempt status for certain organizations and their activities.²⁹ Congress could adapt other legislation it has enacted in the past involving other exempt organizations, such as taxing certain categories of their income,³⁰ to further clarify taxation under section 501(c)(4) itself.

This introduction serves as Part I. Part II gives an overview of the applicable law. Part III reviews the legislative history of the subsection. Part IV describes the make-up of organizations exempt under section 501(c)(4). Part V canvasses the difficulties in constructing a coherent characterization of section 501(c)(4). Part VI examines the border control function of section 501(c)(4). Part VII investigates the border skirmishes involving section 501(c)(4) that have prompted administrative, judicial and congressional action. Part VIII discusses possible reforms, in particular suggesting modifications to a proposal Professor Daniel Halperin has made – taxing the investment income of section 501(c)(4) organizations that operate in ways similar to mutual benefit organizations.³¹ Part IX discusses the possible future of section 501(c)(4) after the 2017 tax legislation. Part X concludes.

²⁹ See *infra* Part VII.

³⁰ See text at *infra* notes 261 and 290, describing tax treatment of homeowners' associations and social clubs.

³¹ Daniel Halperin, *The Tax Exemption under Section 501(c)(4)*, Urban Institute, May 2014, <http://www.urban.org/sites/default/files/publication/22661/413152-The-Tax-Exemption-Under-Section--c-.PDF> (change to symposium issue citation)(hereinafter Halperin, *Section 501(c)(4)*).

II. Overview of Applicable Law

Section 501(c)(4) exempts “social welfare organizations” from income tax.³² The applicable regulations amplify this language, not especially helpfully: “[A]n 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 community.”³³ One court has explained in language no more edifying than the language in the regulations that a section 501(c)(4) organization must be a “community movement designed to accomplish community ends.”³⁴

Indeed, “[s]ince the test for exemption under IRC 501(c)(4) looks to the organization’s primary activities, an organization exempt under IRC 501(c)(4) may engage in substantial non-exempt activities.”³⁵ Thus, as noted earlier, section 501(c)(4) organizations can lobby without limit for issues related to its exempt purpose,³⁶ and engage in candidate campaign intervention

³² Section 501(c)(4) also exempts local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. See § 501(c)(4)(A)(2018). This paper focuses on social welfare organizations, although it does discuss the addition of exemption for local associations of employees in the section on legislative history. Moreover, section 501(c)(4) organizations are often part of a network of organizations, sometimes including both for-profit and non-profit organizations. For example, the National Rifle Association, a section 501(c)(4) organization, runs four affiliated charities and a political action committee. See Samuel Brunson, *Is the NRA an educational organization? A lobby group? A nonprofit? A media outlet? Yes*, The Conversation (March 12, 2018), available at <https://theconversation.com/is-the-nra-an-educational-organization-a-lobby-group-a-nonprofit-a-media-outlet-yes-92806>. See generally HILL & MANCINO, *supra* note 5, Ch. 27 (Complex Structure, Basic Principles, HOPKINS, *supra* note 6 (Part Seven: Interorganizational Structures and Operational Forms). Hill and Mancino observe that “hospitals have developed the most elaborate structure. *Id.* [not sure this should be *id.*] at ¶ 27.01. This article does not examine the role of section 501(c)(4) organizations as part of a network.

³³ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

³⁴ *Erie Endowment v. U.S.*, 316 F.2d 151, 156 (3rd Cir. 1963).

³⁵ John Francis Reilly, Carter C. Hull & Barbara A. Braig Allen, *IRC 501(c)(4) Organizations*, 2003 Continuing Professional Education Text, I-25, available at <https://www.irs.gov/pub/irs-tege/eotopici03.pdf> [hereinafter 2003 CPE Text]. In contrast, organizations exempt under section 501(c)(3) must be organized “for one or more exempt purposes.” Treas. Reg. § 1.501(c)(3)-1(b)(1) (emphasis added). The 2003 CPE Text contrasts the primary activity test applicable to section 501(c)(4) organizations with the rule of *Better Business Bureau v. United States*, 326 U.S. 279 (1945), which according to the 2003 CPE Text stands for the proposition that “the presence of a single noncharitable purpose, if substantial in nature, will disqualify an organization from IRC 501(c)(3) status”. *Id.* at I-25. Courts, however, have applied *Better Business Bureau* to section 501(c)(4) organizations. See, e.g., *Contracting Plumbers Coop. Restoration Corp. v. United States*, 488 F.2d 684, 686 (2d Cir. 1973), *cert. denied*, 419 U.S. 877 (1974); see generally Miriam Galson, *Vision Service Plan v. U.S.: Implications for Campaign Activities of 501(c)(4)s*, 53 EXEMPT ORG. TAX REV. 165 (2006). As this case law and scholarship make clear, how “activities” relate to “purposes” is difficult to discern.

³⁶ See Rev. Rul. 71-350.

so long as such intervention is not its primary activity.³⁷ Similarly, some amount of private benefit is permissible,³⁸ although “[a]n organization that primarily benefits a private group of citizens cannot qualify for IRC 501(c)(4) status,”³⁹ However, under relatively recent statutory language,⁴⁰ the inurement doctrine does apply; that is, insiders may not receive net earnings of a section 501(c)(4) organization. The applicable regulations also mandate that no section 501(c)(4) organization can have as its primary activity “operating a social club for the benefit, pleasure, or recreation of its members” or “carrying on a business with the general public in a manner similar to organizations which are operated for profit.”⁴¹

Section 501(c)(4) organizations are not required to file with the IRS for recognition of exempt status.⁴² Nonetheless, they can choose to apply for exemption, in order, for example, to have assurance of their exempt category. If they file an applications, they now do so on IRS Form 1024-A, a new form issued in January 2018 and developed solely for section 501(c)(4) organizations.⁴³ This form requires an applicant to “describe all of your past, present, and planned activities in a narrative, including the percentage of time and funds spent on these activities” as well as a specific question about past or planned campaign intervention.⁴⁴

In addition, section 501(c)(4) organizations, like other exempt organizations, including section 501(c)(3) organizations, are required to file the Annual Information Return, Form 990 or 990EZ, unless they are below the filing trigger.⁴⁵ The Form 990, in addition to detailed financial

³⁷ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

³⁸ 1981 CPE Text, *supra* note 20.

³⁹ 2003 CPE Text, *supra* note 35, at I-3.

⁴⁰ I.R.C. § 501(c)(4)(B) (2018). See text at *infra* notes 67-71 for discussion of the history of this provision.

⁴¹ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

⁴² See *Instructions for Form 1024-A*, available at <https://www.irs.gov/pub/irs-pdf/i1024a.pdf>.

⁴³ See IRS Form 1024-A, Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code, available at <https://www.irs.gov/pub/irs-pdf/f1024a.pdf>. Prior to development of Form 1024-A, section 501(c)(4) organizations applied for exemption on a general Form 1024. See IRS Form 1024, Application for Exemption under Section 501(a), available at <https://www.irs.gov/pub/irs-pdf/f1024.pdf>. Section 501(c)(3) organizations have their own application form. See IRS Form 1023, Application for Exemption under Section 501(c)(3) of the Internal Revenue Code, available at <https://www.irs.gov/pub/irs-pdf/f1023.pdf>. Section 501(c)(3) organizations, unlike section 501(c)(4) organizations, are required to file an application for exemption to obtain exempt status. See I.R.C. § 508 (2018).

⁴⁴ Form 1024-A, *supra* note 43, Part III, Question 1 and Part V, Question 1.

⁴⁵ See Form 990, Return of Organization Exempt from Income Tax, available at <https://www.irs.gov/pub/irs-pdf/f990.pdf>. Currently, section 501(c)(4) organizations with gross receipts normally less than \$50,000 may file 990-N, an electronic post card; those with gross receipt less than \$200,000 and total assets less than \$500,000 may

information, requires the organization to describe the organization's mission, governance structure, and any significant changes in program services.⁴⁶ Finally, under a provision enacted in 2015, organizations must notify the IRS of intent to operate as a section 501(c)(4) organization within 60 days of formation.⁴⁷ This notice requirement applies whether or not the organization later files an application for recognition of exemption, which remains optional.⁴⁸ This notice requirement does not apply to other organizations exempt under section 501(c).⁴⁹

Also, as noted earlier, with limited exceptions,⁵⁰ donor contributions to section 501(c)(4) organizations are not deductible as charitable contributions under section 170.⁵¹ As is the case with other section 501(c) organizations, including section 501(c)(3) entities, donations of appreciated property do not require recognition of built-in gain.⁵² Again, like other section 501(c) organizations, including section 501(c)(3) charitable organizations, section 501(c)(4) organizations enjoy exemption from tax on income, including investment income, so long as the income is not subject to the unrelated business tax.⁵³ In addition, under section 2501(a)(6), lifetime gifts to section 501(c)(4) organizations as well as section 501(c)(5) labor organizations and section 501(c)(6) trade associations organizations are not subject to gift tax. No parallel provision applies for estate tax purposes. In contrast, charitable contributions to 501(c)(3) organizations are deductible for both gift and estate tax purposes.⁵⁴

file the less detailed Form 990-EZ; organizations with gross receipts equal to or more than \$200,000 and total assets equal to or more than \$500,00 file Form 990. *See IRS, Which forms do exempt organizations file?, available at <https://www.irs.gov/charities-non-profits/form-990-series-which-forms-do-exempt-organizations-file-filing-phase-in>.*

⁴⁶ *See* Form 990, *supra* note 45.

⁴⁷ Section 405 of the Protecting Americans from Tax Hikes Act of 2015, Division Q of the Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242, 3118 [hereinafter the PATH Act of 2015], adding § 506 to the Internal Revenue Code of 1986, as amended.

⁴⁸ *See* text at *infra* notes 78-83.

⁴⁹ *Id.*

⁵⁰ Contributions to organizations serving war veterans and volunteer fire departments are deductible in certain situations. *See IRS, Donations to Section 501(c)(4) Organizations, available at <https://www.irs.gov/charities-non-profits/other-non-profits/donations-to-section-501c4-organizations>.*

⁵¹ In some cases, contributions are deductible as business expenses under section 162. *See* Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Organizations after Citizens United*, 10 ELECTION L.J. 363, 377-79 (2011).

⁵² *Cf.* § 84 (2018) (recognition of gain on transfer of appreciated property to political organizations).

⁵³ *See generally* IRS Publication 598, Tax on Unrelated Business Income of Exempt Organizations, *available at <https://www.irs.gov/pub/irs-pdf/p598.pdf>.*

⁵⁴ *See* I.R.C. §§ 2522, 2055 (2018).

In short, for the most part, the Internal Revenue Code treats section 501(c)(4) organizations in the same way as other noncharitable exempt organizations. Many of the same rules also apply to section 501(c)(3) organizations, but those organizations have more favorable treatment in that their donors are able to deduct contributions for income, gift, and estate tax purposes.

III. Legislative History

As is the case with much tax legislation, the legislative history of section 501(c)(4) reflects a mixture of interest group influence, perceived abuses of the system, anecdotes of uncertain reliability, and the concerns of individual members of Congress.⁵⁵ It offers little insight into the intended purpose and scope of the provision.

Its predecessor was enacted without legislative comment as part of the Tariff Act of 1913, which implemented an income tax.⁵⁶ The exemption provision applied to what are now many different categories of exempt organizations under section 501(c).⁵⁷ The 1913 provision stated that the income tax would not apply to any

labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and providing for the payment of life, sick, accident, and other benefits to the members of such societies, nor to cemetery companies, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or

⁵⁵ See, e.g., Erik M. Jensen, *Legislative and Regulatory Responses to Tax Avoidance*, 57 ST. LOUIS L. J. 1 (2012); Nina J. Crimm, *A Case Study of Private Foundation's Governance and Self-Interested Fiduciaries Calls for Further Regulation*, 50 EMORY L.J. 1095 (200), Daniel Shaviro, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. OF PENN. L. REV. 1 (1990).

⁵⁶ 2003 CPE text, *supra* note 35, at I-2; Tariff Act of 1913, ch. 16, § II (G)(a), 38 Stat. 172.

⁵⁷ These include sections 501(c)(3) (charities), 501(c)(4) (social welfare organizations), 501(c)(5) (labor and agricultural organizations), 501(c)(6) (trade associations, boards of trade real estate boards, and chambers of commerce), 501(c)(8) (fraternal beneficiary organizations), and 501(c)(13) (cemetery companies).

individual, nor to business leagues nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; *nor to any civic league or organization not organized for profit, but operated exclusively for the promotion of social welfare.*⁵⁸

According to the IRS, “It is generally assumed, however, that the enactment [of this provision] was the result of a U.S. Chamber of Commerce’s request for an exemption for ‘civic and commercial’ organizations.”⁵⁹

The concern expressed by the Chamber of Commerce focused far more on trade associations than civic associations. In a letter included in the hearings on the 1913 Act, the Chamber of Commerce requested an amendment to the tariff bill to exempt from tax “commercial organizations not organized for profit.”⁶⁰ The letter explained that the commercial organizations not organized for profit, which seems to refer to business leagues, chambers of commerce, real-estate boards, and boards of trade now covered by section 501(c)(6), merited exemption: “The commercial organization of the present day is not organized for selfish purposes, and performs broad patriotic and civic functions.”⁶¹ The letter did not discuss “civic organizations,”⁶² and the inclusion of this category may have been at least gratuitous if not accidental. Nothing in the legislative history addresses any Congressional intention to exempt civic organizations.

⁵⁸ *Id.* (emphasis added). The Senate added “business leagues, chambers of commerce, or boards of trade not organized for profit and civic organizations operated exclusively for the promotion of social welfare” to the House provision listing exempt organizations. Committee Reports on Act of October 3, 1913; House of Representatives Report No. 5, 63rd Congress, 1st Sess. (April 22, 1913).

⁵⁹ 2003 CPE text, *supra* note 35, at I-2 (citing *Hearings on Tariff Schedules of the Revenue Act of 1913 Before the Subcomm. of the Comm. on Finance*, 63d Cong., 1st Sess. 1 2001 (1913)).

⁶⁰ *Hearings on Tariff Schedules of the Revenue Act of 1913 before the Subcomm. of the Comm. on Finance*, 63d Cong., 1st Sess. 1 2001 at 2001-2 (1913), Letter from Elliot H. Godwin, General Secretary of Chamber of Commerce. The letter pointed out that under the Tariff Act of August 5, 1909, tax applied to “every corporation, joint-stock company or association organized for profit.” *Id.* Unlike the 1913 Act, the 1909 Act did not specifically list which entities qualified as tax-exempt and thus had no need to make mention of commercial organizations. *Id.*

⁶¹ *Id.*

⁶² As he discusses in his paper for this symposium, Lloyd Mayer has found that at the time of the 1913 Tariff Act a number of civic leagues had been established to encourage government and political reform, including women’s suffrage. [insert cross reference]

Section 231(8) of the Revenue Act of 1921 exempted “[c]ivic leagues not organized for profit but operated exclusively for the promotion of social welfare.”⁶³ Congress amended the statute in 1924 to include local associations of employees that had earlier been denied exempt status because they provided services to a limited group of beneficiaries.⁶⁴ A Senate Report explains:

Paragraph (8) has been extended to apply to local associations of employees the membership of which is limited to employees of a designated person or person in a particular municipality and the net earnings of which are developed exclusively to charitable, educational, and recreation purposes, whether or not for the benefit of individual members and their families. Such organizations frequently perform a service similar to that which forms the basis of the exemption accorded in paragraphs (8) and (9) of section 231 of the existing law. They have been accorded exemption expressly, since it is doubtful if such organizations are exempt under current law.⁶⁵

When the tax law was codified in 1939, section 101(8) exempted civic leagues and associations of employees in language identical to today’s section 501(c)(4)(A).⁶⁶

More than 50 years later, as part of The Taxpayer Bill of Rights 2,⁶⁷ Congress in 1996 added language to section 501(c)(4) explicitly prohibiting any private inurement. At the time of the legislation, section 501(c)(3) and a number of other provisions of section 501(c) forbade inurement, but section 501(c)(4) did not.⁶⁸ The same legislation introduced a new provision, section 4958, and included section 501(c)(4) organizations along with public charities as subject to

⁶³ Revenue Act of 1921, ch. 136, § 231(8), 67th Cong. Sess. 1.

⁶⁴ 2003 CPE text, *supra* note 35, at I-2, citing Revenue Act of 1924, ch. 234, § 231(8), 43 Stat. 282.

⁶⁵ STAFF OF THE SENATE COMM. ON FINANCE, STATEMENT OF THE CHANGES MADE IN THE REVENUE ACT OF 1921 AND THE REASON THEREFOR, 68TH CONG. 1st Sess. at 23 (Comm. Print 1924.) Section 231(8) before amendment applied to “[c]ivic leagues or organization not organized for profit but operated exclusively for the promotion of social welfare.” Section 231(9) applied to “[c]lubs organized and operated for pleasure, recreation, and other nonprofit purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member.” Section 231(8), (9) of the Revenue Act of 1921, *supra* note 63.

⁶⁶ See I.R.C. of 1939, ch. 1, § 101(8), 53 Stat. 33 (1939).

⁶⁷ Pub. L. No. 104-168, § 1311(b)(1) and (b)(2), 110 Stat. 1452, adding § 501(c)(4)(B) to the Internal Revenue Code of 1986, as amended.

⁶⁸ In addition to section 501(c)(3), provisions prohibiting inurement at the time included section 501(c)(6) (business leagues), 501(c)(7) (social clubs), 501(c)(9) (voluntary employees’ beneficiary associations), 501(c)(11) local teacher retirement funds), 501(c)(13) (cemetery companies), 501(c)(19) (veterans associations), and 501(c)(26) (high risk individual health care coverage organizations).

the regime it introduced. Under this intermediate sanction regime, certain disqualified persons (and in some cases organizations' managers as well) are subject to excise taxes for "excess benefit transactions" with exempt organizations.⁶⁹ The addition of the inurement language to section 501(c)(4) and the inclusion of section 501(c)(4) entities as organizations subject to intermediate sanctions reflected long-held concerns by Rep. Pete Stark of California regarding HMOs,⁷⁰ particularly in connection with nonprofit to for-profit conversions.⁷¹

In December 2016, legislation known as The Protecting Americans from Tax Hikes (PATH) Act of 2015, became part of the Consolidated Appropriations Act of 2016.⁷² In this legislation, Congress provided that the gift tax would not apply to contributions to section 501(c)(4), (c)(5) and (c)(6) organizations.⁷³ This new provision followed a 2011 furor about reported audits of gifts to politically active section 501(c)(4) organizations after many years of the IRS failing to impose the gift tax on such transfers.⁷⁴ Republicans in both the Senate and the House questioned these audits.⁷⁵ The IRS suspended the audits and made a plea for Congress to clarify legislatively whether the gift tax applied to contributions to section 501(c)(4) organizations.⁷⁶ Five years later, Congress did so as part of the PATH Act.

Two other provisions of the PATH Act affected section 501(c)(4) organizations. These provisions were added in response to the tremendous controversy involving IRS inquiries and

⁶⁹ Pub. L. No. 104-168, § 1311(b)(1)(b)(2), 110 Stat. 1452, codified as section 4958. An excess benefit transaction is one in which the economic benefit received by a disqualified person exceeds the economic benefit received by the organization. See I.R.C. § 4958(c)(1) (2018).

⁷⁰ HMOs generally organize as section 501(c)(4) organizations. See text at *infra* notes 202-224 for further discussion of HMOs.

⁷¹ See Bernadette M. Broccolo, Kathleen M. Nilles, Michael W. Peregrine & T. J. Sullivan, *Rules to Live by: IRS Released Intermediate Sanction Regulations*, 98 TNT 173-77 (Sept. 8, 1998); Congressional Research Service, *Tax Aspects of Health Care Reform: The Tax Treatment of Health Care Providers*, 94 TNT 94-90 (April 25, 1994); Lee A. Sheppard, *HMO Conversions and Self-Dealing*, 93 TNT 206-5 (Oct. 6, 1993).

⁷² PATH Act of 2015, *supra* note 47.

⁷³ PATH Act of 2015, *supra* note 47.

⁷⁴ See Stephanie Strom, *IRS Moves to Tax Gifts to Groups Active in Politics*, N.Y. TIMES, MAY 12, 2011, available at <http://www.nytimes.com/2011/05/13/business/13gift.html>; *IRS Confirms Examinations of Donors to Social Welfare Groups*, 2011 TNT 94-2 (May 26, 2011).

⁷⁵ See *Senate Republican Question IRS on Gift Tax Enforcement*, 2011 TNT 97-31 (May 19, 2011); *Camp Says IRS Tax Investigations May Be Targeting Political Speech*, 2011 TNT 116-39 (June 16, 2011).

⁷⁶ See *IRS Suspends Exam on Application of Gift Tax to Contributions Made to Some Exempt Orgs*, 2011 TNT 131-18 (July 18, 2011); *IRS Halts Gift Tax Exams of 501(c)(4) Donors, Won't Start More*, 2011 TNT 131-2 (July 8, 2011). See also Ellen P. Aprill, *Once and Future Gift Taxation of Transfers to Section 501(c)(4) Organizations: Current Law, Constitutional Issues, and Policy Considerations*, 15 NYU J. OF LEG. AND PUB. POL. 289 (2012).

delays in connection with the application for exemption under section 501(c)(4) by conservative organizations, particularly Tea Party organizations.⁷⁷ As mentioned earlier, one such provision, codified as new section 506, added a requirement that, with some exceptions, an entity described in section 501(c)(4) and organized after December 18, 2015 notify the IRS within 60 days after the entity is established of its intent to operate as a section 501(c)(4) organization.⁷⁸ The IRS must, within 60 days of a receipt of this notice, issue an acknowledgment.⁷⁹ Filing such notice, however, does not constitute an application for exemption, which is now done on a special form, Form 1024-A.⁸⁰ The legislation also amended section 7428 to permit all organizations seeking exemption under 501(c), and not just those seeking exemption under 501(c)(3), to seek a declaratory judgment from a court as to their status in certain situations involving determination or revocation of exempt status by the IRS.⁸¹

Although the amendment to the declaratory judgment provision of section 7428 applies to more than section 501(c)(4) organizations, the House Report emphasizes that “section 501(c)(4) organizations that receive an adverse determination or upon examination have their exempt status revoked have limited recourse.”⁸² Regarding the notice requirement, the legislative history declares:

In recent years, section 501(c)(4) organizations that file an application for recognition of exempt status have faced considerable delays in obtaining a determination from the IRS. . . . The Committee therefore believes it is desirable to eliminate the

⁷⁷ See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW (May 14, 2013), *supra* note 2. See also New York State Bar Association letter of April 11, 2016, available at https://www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Reports_2016/Tax_Section_Letter_1341.html.

⁷⁸ PATH Act of 2015, *supra* note 47, §405 adding § 506 to the Internal Revenue Code of 1986, as amended. Failure to file can subject the organization to a penalty of \$20 per day (but no more than \$5,000) and, if the organization fails to file the notice after the IRS makes a written demand, additional penalties of \$20 per day, up to \$5,000 in aggregate) on the organization managers. *Id.*

⁷⁹ *Id.*

⁸⁰ See *supra* note 43.

⁸¹ PATH Act of 2015, *supra* note 47, §406, adding §7428(a)(1)(E) to the Internal Revenue Code of 1986, as amended. In response to a mandate in the PATH Act, the IRS has recently created Form 1024-A specifically for use by organizations seeking exemption under section 501(c)(4). Fred Stokeld, *More Time Needed To Review EO Form, Practitioners Say*, 2017 TNT 188-7 (Sep. 29, 2017). See text at *supra* notes 43-44 for discussion of Form 1024-A.

⁸² H.R. Rep. No. 114-71 (2015) at 11.

need for a section 501(c)(4) organizations that desires written IRS acknowledgment of its exempt status to apply for a formal IRS determination.⁸³

This explanation is misleading. An acknowledgment that an organization claims section 501(c)(4) status does not constitute IRS acceptance of that characterization. The legislative history recognizes this fact by noting that “[a] section 501(c)(4) organization that desires additional certainty regarding its qualification as an organization described in section 501(c)(4) may file a request for determination . . .”⁸⁴

Individual members of Congress tied this provision directly to the IRS controversy over Tea Party exemption applications. Then-Representative Charles W. Boustany, Jr., M.D. (R-La.), who first introduced the legislation that became section 506, issued a press release stating that the impetus for the legislation was the “unfair partisan targeting” of section 501(c)(4) organizations by the IRS and that the legislation was needed to “provide a checks and balances system to the actions of unelected Washington bureaucrats” and to stop “abuse of American taxpayers by the IRS.”⁸⁵ Thus, recent legislative activity regarding section 501(c)(4) organizations resulting from perceived abuse by the IRS in connection with section 501(c)(4) organizations planning to participate in campaign intervention.⁸⁶ As described below, such activity involves a small fraction of section 501(c)(4) entities, albeit an important aspect for policy reasons. Here, as elsewhere, Congress has revised provisions applicable to tax-exempt organizations in a piecemeal fashion, rather than addressing section 501(c)(4) or organizations exempt under section 501(c) more generally.⁸⁷

⁸³ H.R. Rep. No. 114-71 at 8 (footnote omitted).

⁸⁴ H.R. Rep. No. 114-71 at 9. Section 506 (f) specifies, “Upon request by an organization to be treated as an organization described in section 501(c)(4), the Secretary may issue a determination with respect to such treatment.” I.R.C. § 506(f) (2018).

⁸⁵ Press Release, Boustany Defends Taxpayers Against Unfair IRS Targeting (Nov. 19, 2013), cited by New York State Bar Association letter of April 11, 2016, *supra* note 77.

⁸⁶ Congress in the Consolidated Appropriations Act, 2018, H.R. 1625, § 125, P.L. 115-141, has also denied the IRS the use of any funds to work on guidance relating to the definition of campaign intervention under section 501(c)(4).

⁸⁷ For criticism of this piecemeal approach as well as an argument that Congress should address section 501(c) more generally, see Roger Colinvaux, *Charity in the 21st Century: Trending toward Decay*, 11 FLA. TAX REV 1, 48 (2011). For a set of suggestion for reforming section 501(c) as a whole, see David S. Miller, *Reforming the Taxation of Exempt Organizations and Their Patrons*, 67 TAX. LAW. 451, 492 (2014).

IV. The Topography of Section 501(c)(4)

According to the Koulish 2016 study based on data available from the National Center on Charitable Statistics (NCCS),⁸⁸ “‘social welfare’ organizations are the second-most common type of nonprofit organization registered with the Internal Revenue Service,”⁸⁹ after section 501(c)(3) organizations. The disparity in number of organizations between the two categories, however, is enormous. The Internal Revenue Service Data Book, Fiscal Year 2017, reports that, based on the number of organization that applied for tax-exempt status or were exempt by virtue of a tax treaty, those exempt under section 501(c)(3) numbered 1,286,181 and those exempt under section 501(c)(4) numbered 81,935.⁹⁰ Moreover, while section 501(c)(3) public charities grew 20.6% between 2003 and 2013, from 783, 811 to 945,393, according to the NCCS, the number of section 501(c)(4) organizations declined 31.4% from 119,772 to 82,197 during the same period.⁹¹

Reported numbers are difficult to interpret and compare. The Internal Revenue Service Data Book, Fiscal Year 2014 gives the number of section 501(c)(4) organizations as 68,2018.⁹² In contrast, Koulish, using the IRS Business Master File, June 2014 and NCCS Core File 2012, gives the total number of registered section 501(c)(4) organizations as 81,589. He also reports the number filing Form 990 as 28,906.⁹³ Koulish explains, “The Business Master File contains basic information on every organization registered with the IRS and believed to be active. The

⁸⁸ See Nat’l Ctr. for Charitable Statistics, *Guide to Using NCCS Data*, available at <http://nccs-data.urban.org/NCCS-data-guide.pdf>.

⁸⁹ Koulish, *supra* note 17, at 1. “Registered” for these purposes means filing an application for exemption. *Id.* at 31, note 16.

⁹⁰ Internal Revenue Service Data Book, Fiscal Year 2017, Table 25, available at <https://www.irs.gov/pub/irs-soi/17databk.pdf>. The Internal Revenue Service Data Book, Fiscal Year 2016, reports that organizations exempt under section 501(c)(3) numbered 1,237,094 and those exempt under section 501(c)(4) numbered 83,392. INTERNAL REVENUE SERVICE DATA BOOK, FISCAL YEAR 2016, TABLE 25, available at <https://www.irs.gov/pub/irs-soi/16databk.pdf>.

⁹¹ Nat’l Ctr. for Charitable Statistics at the Urban Institute, Number of Nonprofit Organizations in the United States, 2003-2013, available at <http://nccsweb.urban.org/PubApps/profile1.php?state=US> (based on IRS Business Master Files, with modifications by the National Center for Charitable Statistics at the Urban Institute to exclude foreign and governmental organizations).

⁹² INTERNAL REVENUE SERVICE, DATA BOOK, FISCAL YEAR 2014, Table 25, available at <https://www.irs.gov/pub/irs-soi/14databk.pdf>. SAY.

⁹³ Koulish, *supra* note 17, at 5, Table 1. He also observes that more than half of section 501(c)(4) organizations were formed before 1970. *Id.* at 13 and Figure 3.

NCCS Core File captures financial information for every organization filing a Form 990 return and is considered the more accurate estimator of aggregate sector activity.”⁹⁴

Although these numbers give a general sense of the size of the sector, they all must be taken with a grain of salt. On one hand, section 501(c)(4) organizations are not required to apply for recognition of exemption; thus, numbers based on registration may understate the number of section 501(c)(4) organizations. Data based on 990 filings may also understate the number of section 501(c)(4) organizations because many section 501(c)(4) organizations may be small enough to avoid the Form 990 or 990EZ filing trigger.⁹⁵

Differences in other sets of reported data also complicate the ability to chart accurately the growth of the sector based on filing of applications for exemption. Relying on information provided by the IRS Exempt Organization function, the Treasury Inspector General, in connection with his investigation of the handling of Tea Party applications, reported the number of new section 501(c)(4) applications received by the IRS from 2009-2012.⁹⁶ Koulish, using the NCCS NTEE Master File,⁹⁷ reports quite different numbers over that same time period.⁹⁸ Moreover, many hundreds, even thousand, of foreign-organized entities could be section 501(c)(4) organizations.⁹⁹

Year	TITGA/IRS # of Applications	Koulish, NCCS # of new (c)(4)s
2009	1,751	1,373
2010	1,735	2,674
2011	2,265	1,610
2012	3,357	1,990

⁹⁴ Koulish, *supra* note 17, at 4.

⁹⁵ See *supra* note 45.

⁹⁶ TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, *supra* note 2.

⁹⁷ The NCCS describes the NCCS NTEE Master File as a cumulative list of organizations EINs and NTEE (National Taxonomy of Exempt Organizations classifications). See National Center for Charitable Statistics, Guide to Using NCCS Data, available at <http://nccs-data.urban.org/NCCS-data-guide.pdf>.

⁹⁸ Koulish, *supra* note 17, at 14, Figure 4. It is not clear to me how these two sets of numbers relate. Section 501(c)(4) organizations need not apply for exemption; they do, however, obtain EINs. I would expect the number of new section 501(c)(4) organizations to be larger than the number of applications, even if we allow for a year or so lag, but that is not the case.

⁹⁹ See New York State Bar Association letter, *supra* note 77.

Both sets of numbers seem to suggest that section 501(c)(4) formation increased in response to *Citizens United*. Koulish, however, cautions that “the reality is likely more complex . . . [T]he increase in the number of new organizations formed in 2010 is almost entirely attributable to a single organization, the American Association of University Women, which had 1,093 local chapters approved by the IRS in a group ruling.”¹⁰⁰

The IRS reported in its annual Data Book for each of the listed years the following information regarding closing of cases involving application disputes, whether approval or disapproval of exemption, for tax-exempt status under section 501(c)(4):¹⁰¹

Fiscal Year	Total Closed	Approved	Disapproved	Other ¹⁰²
2008	1,492	1,202	d	d
2009	1,922	1,507	3	412
2010	1,741	1,447	3	291
2011	1,777	1,559	6	212
2012	2,774	2,324	8	442
2013	2,253	1,784	5	464
2014	4,417	4,114	8	295
2015	2,375	2,134	d	d
2016	1,877	1,690	d	d
2017	1,487	1,379	3	d

d– Not shown to avoid disclosure of information about specific taxpayers. However, the data are included in the appropriate totals.

Again, it is not clear how to reconcile these numbers from the IRS Data book regarding the number of application approved with the numbers of new section 501(c)(4) organizations provided by Koulish.

¹⁰⁰ Koulish, *supra* note 17, at 14.

¹⁰¹ My thanks to Lloyd Mayer for his help with this table.

¹⁰² INTERNAL REVENUE SERVICE, DATA BOOK, FISCAL YEAR 2009, at 56, Table 25, *available at* <https://www.irs.gov/pub/irs-soi/09databk.pdf>, states: “Includes applications withdrawn by the organization; applications that did not provide the required information; incomplete applications; IRS refusals to rule on applications; applications forwarded to other than the Washington, DC office; IRS correction disposals; and others.”

Changes in IRS policy can mislead researchers. For example, Koulish wonders why the number of new section 501(c)(4) organizations jumped from 1,516 in 2013 to 4,000 in 2014 when the “list of new organizations approved for tax-exempt status is unremarkable; it closely mirrors the social welfare universe as a whole.”¹⁰³ The Internal Revenue Service Data Book, Fiscal Year 2014 reports the number of new section 501(c)(4) organizations as 4,114, but notes that this data item “overstates the number of social welfare organizations” as a result of “a processing change that occurred in FY2014.”¹⁰⁴

Of importance going forward in obtaining somewhat more accurate numbers of section 501(c)(4) organizations, new section 506, discussed above, requires an organization to notify the IRS of its intent to operate as a section 501(c)(4) organization within 60 days of its formation, with some exceptions for organization that have already filed Form 990. The IRS developed Form 8976 for electronic filing of such notices and began accepting the form on July 8, 2016.¹⁰⁵ The Internal Revenue Service Data Book, Fiscal Year 2017, reports that the IRS received 2,182 Forms 8976, acknowledged 1,908 of them and rejected 474.¹⁰⁶

¹⁰³ Koulish, *supra* note 17, at 14, Figure 4.

¹⁰⁴ INTERNAL REVENUE SERVICE DATA BOOK, FISCAL YEAR 2014, *supra* note 92, at 54. This source explains further that the number included organizations that had applied for an employer identification number, but had not filed the application form, and that going forward, the table would include only organizations that have filed the appropriate application form and have been recognized as exempt by the IRS or as a result of a tax treaty. *Id.* The Teacher’s Manual Update for JAMES J. FISHMAN, STEPHEN SCHWARZ, AND LLOYD HITOSHI MAYER, NONPROFIT ORGANIZATIONS: CASES AND MATERIALS 305 (5th Ed. 2015) [hereinafter “Fishman, Schwarz, Mayer”] considers the impact of using the total number of 501(c)(4) organizations, rather than the number of new ones: “The sharp increase in the number of 501(c)(4) organizations recognized by the IRS in 2014 (from 91,056 in 2013 to 148,585) is apparently the result of an error on the part of the Service. According to an IRS employee, this increased represents ‘entities that have applied for an [Employer Identification Number] as an exempt organizations (EO) but have not yet filed a Form 1023 or 1024 and obtained an EO determination.’ Such entities are therefore not necessarily claiming exemption under § 501(c)(4). See Lloyd Hitoshi Mayer, *The Better Part of Valour is Discretion: Should the IRS Change or Surrender Its Oversight of Tax-Exempt Organizations?*, 7 COLUM. J. TAX L. 81, 84 n. 11 (2016).” (Teacher’s Manual on file with author).

¹⁰⁵ In addition, the IRS has promulgated regulations regarding the new section 506 notice, and these regulations require foreign organizations to file the notice, see Treas. Reg. § 1.506-1T(a)(1), despite the argument of the New York State Bar to the contrary. See New York State Bar Association letter, *supra* note 77.

¹⁰⁶ INTERNAL REVENUE SERVICE DATA BOOK, FISCAL YEAR 2017, *supra* note 90, at 55 Table 24b. The Internal Revenue Service Data Book, Fiscal Year 2016, reports that the IRS received 1,427 Forms 8976, acknowledged 1,036 of them and rejected 149. INTERNAL REVENUE SERVICE DATA BOOK, FISCAL YEAR 2016, *supra* note 90, Table 24(b). Of course, not all organization that file the notice may in fact be described in section 501(c)(4).

Whatever the exact numbers, Koulish's 2016 study of section 501(c)(4) offers important insight into the make-up of the subsector. He finds that "[a] clear majority of social welfare organizations can be naturally categorized as voluntary associations that offer some broader community benefit but that do not qualify as public charities because in most cases, membership eligibility is restricted in some manner."¹⁰⁷ The most common types of section 501(c)(4) organizations are community service clubs, volunteer fire departments, veterans' organizations, and sports and recreational clubs open to the broader community;¹⁰⁸ those generating the most revenue are hospital chains and HMO providers.¹⁰⁹ The largest organizations are health providers or insurers along with the AARP, a financing organization for rural utilities, the governing bodies of the Olympics and of international soccer, and a locally owned racetrack and casino complex in Iowa.¹¹⁰ Koulish concludes that section 501(c)(4) advocacy, whether lobbying or campaign intervention, for the most part takes place in less than one-third of section 501(c)(4) organizations and generates less than one-seventh of the subsector's revenue.¹¹¹

Health organizations, fire departments, veterans' organizations, and sports activities all raise special questions that will be addressed in subsequent parts of this paper.¹¹² However, a brief examination of two of the largest section 501(c)(4) organizations – AARP and Rotary International – gives a further sense of the range of activities in which section 501(c)(4) organizations engage. Because these organizations are well-known to the public (although the public may not realize that they are section 501(c)(4) organizations), they serve as useful vehicles for examining section 501(c)(4).

¹⁰⁷ Koulish, *supra* note 17, at 6. I reproduce in Appendix A Koulish's tables of section 501(c)(4) organizations by type, revenue, and size.

¹⁰⁸ Koulish, *supra* note 17, at 5, Table 1.

¹⁰⁹ *Id.* Health providers and insurers generated \$62,715,346,590 (72.5%) of section 501(c)(4) revenue. *Id.*

¹¹⁰ Koulish, *supra* note 17, at 5-6, 8.

¹¹¹ Koulish finds the 2001 study by Jeff Krehely & Kendall Gollady, *supra* note 19, to support many of the conclusions in this study. Koulish, *supra* note 17, at 6.

¹¹² [I am not sure how best to cite to so many different topics – I leave that to you]

Rotary International has been in existence for more than 110 years¹¹³ and obtained its exemption as a section 501(c)(4) organization in 1958.¹¹⁴ Its purpose is to support local clubs by coordinating international programs and initiatives. GuideStar, using the IRS Business Master File, gives its gross receipts as \$182,402,209 and assets as \$159,664,981.¹¹⁵ Rotary International's 2016 Form 990 reports 1,215,267 volunteers, revenue less expenses of \$3,777,119 (with membership fees as the largest source of revenue), and net assets of \$126,582,158.¹¹⁶ Rotary International engages in a number of charitable activities, including promoting peace; fighting disease; providing clean water, sanitation, and hygiene; saving mothers and children; supporting education and growing local economies.¹¹⁷

The organization's motto is "Service Above Self."¹¹⁸ It describes its objective generally as encouraging and fostering "the ideal of service as a basis of worthy enterprise"¹¹⁹ and, in particular, to encourage and foster:

FIRST: The development of acquaintance as an opportunity for service;

SECOND: High ethical standards in business and professions; the recognition of the worthiness of all useful occupations, and the dignifying of each Rotarian's occupation as an opportunity to service society.

THIRD: The application of the ideal of service in each Rotarian's personal, business, and community life;

¹¹³ Rotary International webpage, Our History, <https://www.rotary.org/en/about-rotary/history>. It was formed by Chicago attorney on February 23, 1905 "so that professionals with diverse background could exchange ideas, form meaningful, lifelong friendships, and give back to their communities." *Id.* Its name comes from the group's early practice of rotating meetings among the offices of its members. *Id.*

¹¹⁴ GuideStar, <https://www.guidestar.org/profile/36-1707667>.

¹¹⁵ GuideStar, <https://www.guidestar.org/search>, Rotary International search.

¹¹⁶ GuideStar, Rotary International Form 2016, *available at* <https://www.guidestar.org/FinDocuments/2016/361/707/2016-361707667-0dfe7f9e-90.pdf>.

¹¹⁷ Rotary International website, Who We Are, <https://www.rotary.org/en/about-rotary>. Like many section 501(c)(4) organizations, it has a sister 501(c)(3), the Rotary Foundation, to fund its humanitarian activities. The Foundation's Form 990 for 2015 reported revenue less expenses of \$ 9,438,693 and net assets of \$930,133,001. 693. *See* Guidestar, Rotary Foundation of Rotary International, 2015 Form 990, *available at* <https://www.guidestar.org/FinDocuments/2016/363/245/2016-363245072-0dfdd7c7-9.pdf>. (A number of local chapters of Rotary have also formed their own foundations. [NOTE – NOT WORTH GIVING CITATIONS, SO DELETE LAST SENTENCE IF YOU WANT])

¹¹⁸ Rotary International website, Who We Are, <https://www.rotary.org/en/about-rotary>.

¹¹⁹ Rotary International webpage, Guiding Principles, Object of Rotary, <https://my.rotary.org/en/guiding-principles>.

FOURTH: The advancement of international understanding, good will, and peace through a world fellowship of business and professional persons united in the ideal of service.¹²⁰

Rotary International operates through its clubs or chapters.¹²¹ The Rotary International's webpage describes members of these clubs as people who "share a passion for community service and friendship."¹²² It further explains that "Rotary members share ideas, make plans, hear from the community, and catch up with friends during club programs that fuel the impact we make."¹²³ Moreover, a club connection offers members a "chance to develop skills like public speaking, project management, and event planning."¹²⁴

Rotary International is a section 501(c)(4) organization because of the membership requirement and the explicit offer of personal benefits in addition to and apart from the undertaking of charitable endeavors. It lists as primary among its objectives "the development of acquaintance as an opportunity for service;"¹²⁵ that is, personal networking has a high priority. More importantly, for purposes of the private benefit doctrine, members also receive discounts on products and services.¹²⁶

AARP (formerly the American Association of Retired Persons), was founded in 1958¹²⁷ and received exemption in 1967.¹²⁸ It describes itself "as a nonprofit, nonpartisan social welfare organization with a membership of nearly 38 million that helps people turn their goals and dreams into real possibilities, strengthens communities and fights for the issues that matter most to families—such as health care, employment and income security."¹²⁹ It is the largest

¹²⁰ *Id.*

¹²¹ The website states there are more than 35,000 of such clubs internationally. Rotary International website, *Who We Are*, <https://www.rotary.org/en/about-rotary>. Koulisch reports 3,298 chapter in the United States and notes that many chapters are small. Koulisch, *supra* note 17, at 7.

¹²² Rotary International website, *Rotary Clubs*, <https://www.rotary.org/en/get-involved/rotary-clubs>.

¹²³ *Id.*

¹²⁴ Rotary International website, *Rotary Clubs, Club Benefits*, <https://www.rotary.org/en/get-involved/rotary-clubs>.

¹²⁵ Rotary International website, *Membership*, <https://www.rotary.org/en/about-rotary/membership>.

¹²⁶ Rotary International website, *Rotary Global Rewards*, <https://my.rotary.org/en/member-center/rotary-global-rewards/offers#/offer>.

¹²⁷ AARP website, *AARP History*, <http://www.aarp.org/about-aarp/company/info-2016/history.html>.

¹²⁸ GuideStar, *AARP*, <https://www.guidestar.org/profile/95-1985500>.

¹²⁹ *About AARP: Our Mission*, <http://www.aarp.org/about-aarp/?cmp=ORG-DSO-POSTS-GOOGLE-AARP-7-13-2017-SPOT1B>.

501(c)(4) by gross receipts and second largest by total assets.¹³⁰ AARP's 2016 Form 990 lists revenue in excess of expenses as \$41,452,020 and net assets as \$1,154,119,978.¹³¹

AARP's home page on its website prominently displays to a link listing member benefits.¹³² A 21-page booklet describes the benefits, from discounts at restaurants to health programs, available to members.¹³³ Its webpage also provides information on a wide variety of topics, such as food, health, money, politics, and society.

AARP is actively engaged in advocacy on issues of importance for "individuals age 50 and over individuals and their families at the local, state and national levels."¹³⁴ Koulisch describes AARP as "widely considered one of the most powerful lobbying organizations in the country."¹³⁵ Despite the high absolute number, AARP's total spending on direct lobbying over 17 years was less than one-fifth of its overall spending in 2012 alone.¹³⁶ That is, even for the largest and most politically active section 501(c)(4) organizations, the percentage of its resources spent on advocacy is small.

¹³⁰ NCCS, Organizations by IRS Subsection, *available at* <http://nccsweb.urban.org/PubApps/showOrgsByCategory.php?group=subsection&code=04>. NCCS gives its gross receipts as \$31,659,822,817 and total assets as \$2,330,580,646. These numbers appear to be out of date. GuideStar gives quite different numbers - gross receipts as 4,234,099,495 and its net assets as 2,3471,948,522. GuideStar, <https://www.guidestar.org/search>, AARP search.

¹³¹ Guidestar, AARP 2016 Form 990, *available at* <https://www.guidestar.org/FinDocuments/2016/951/985/2016-951985500-0e895bd4-90.pdf>. Among its related entities, AARP has a sister foundation, with gross receipts of \$74,358,878 and assets of \$266,584,963. Guidestar, <https://www.guidestar.org/search>, AARP Foundation search. The Foundation's 2016 Form 990 reports revenue in excess of expenses of \$134,090,513 and net assets of \$214,726,689. GuideStar, <https://www.guidestar.org/FinDocuments/2016/520/794/2016-520794300-0e996d6c-9.pdf>. AARP's complex structure, which includes a number of tax-exempt and taxable organizations, as well as the amount of its royalty income has been the subject of a Congressional Hearing and a report titled "Behind the Veil: The AARP America Doesn't Know." The report questioned whether AARP was operating primarily for the benefit of the community. See David Van den Berg, *AARP's Structure, Royalty Income Addressed at House Subcommittee Hearing*, 2011 TNT 64-9 (Apr. 4, 2011).

¹³² AARP website, Your Membership, <http://www.aarp.org>.

¹³³ AARP website, Your Member Benefits, http://www.aarp.org/content/dam/aarp/benefits_discounts/membership_services/2013-06/MBCHAE-GUIDE-GEN.pdf.

¹³⁴ About AARP, Social Impact, Advocacy, <http://www.aarp.org/about-aarp/company/social-impact/>.

¹³⁵ Koulisch, *supra* note 17, at 8. OpenSecrets.org has found that between 1998 and 2017, AARP spent \$266 million on lobbying, eighth among all entities. Open Secrets, Top Spenders (All years: 1998-2017), <https://www.opensecrets.org/lobby/top.php?indexType=s>.

¹³⁶ Koulisch, *supra* note 17, at 17.

Koulish's analysis of the section 501(c)(4) subsector along with the examination of two of the most prominent section 501(c)(4) organizations demonstrates the breadth of the subsector. This description shows that associating section 501(c)(4) primarily with organizations engaged in political activity, whether lobbying or campaign intervention, views the universe of section 501(c)(4) too narrowly.

V. The Murkiness of the Section 501(c)(4) No Man's Land

Most commentators on section 501(c)(4) detect no coherent policy behind the subsection. According to Koulish, the sector as a whole proves "exceedingly difficult to describe comprehensively."¹³⁷ Professor Daniel Halperin states, "The world of section 501(c)(4) cannot be neatly described."¹³⁸ Hopkins writes that the very notion of social welfare is confusing "because of the considerable similarity between these entities and those that are *charitable* in nature; *promotion of social welfare* is one of the definitions of a tax-exempt charitable organization."¹³⁹

Hill and Mancino make a heroic stab at coherence. They see the "initial and intended focus" of section 501(c)(4) to have been "on organizations that engage in self-help for civic benefit."¹⁴⁰ They continue:

As originally conceived, Section 501(c)(4) covered situations in which contributors and beneficiaries are in substantial part the same persons based on a self-help concept, whereas Section 501(c)(3) organizations are based on a charity concept in which contributors provide assistance to a charitable class of beneficiaries other than themselves. The only reason for having two separate types of exempt organizations was that Section 501(c)(4) self-help model appeared to present private benefit issues that might prove troublesome under Section 501(c)(3).¹⁴¹

¹³⁷ Koulish, *supra* note 17, at 2.

¹³⁸ Halperin, *Section 501(c)(4)*, *supra* note 31, at [page in symposium issue].

¹³⁹ Hopkins, *supra* note 6, at 389 (emphasis in original).

¹⁴⁰ Hill & Mancino, *supra* note 5, at ¶ 13.01.

¹⁴¹ *Id.*

Such a “self-help” characterization would describe a large number of section 501(c)(4)s, including the AARP, HMOs, and even the American Association of University Women, but would not by any means capture all of the section 501(c)(4) universe, including the large number of community service clubs. The notion that the contributors are also beneficiaries is an important one, however, and one to which the article will return at length in Part VIII.

Section 501(c)(4) social welfare organizations must pass both a positive and negative test. As described in the following paragraphs, they must provide community benefit, but not benefit primarily a private group of citizens. The issue of private benefit, the meaning of community, and how these two concepts relate are the crucial elements of section 501(c)(4).

The positive test is that a section 501(c)(4) organization must provide a community benefit.¹⁴² Thus, section 501(c)(4) requires defining community for this purpose. Early case law articulates inspiring generalities that, like the language of the regulations, give little practical guidance. *United States v. Pickwick Electric Membership Corp.*, which held an electric cooperative exempt under a predecessor statute to section 501(c)(4), characterized a civic organization as advancing “the idea of citizens of a community cooperating to promote the common good and general welfare of the community.”¹⁴³ *Erie Endowment v. United States*, denying section 501(c)(4) status to an organization funded and controlled by a single individual, decreed that a civic organizations must be a “community movement designed to accomplish community ends.”¹⁴⁴

The court in *Eden Hill Farm v. United States*¹⁴⁵ demonstrates the difficulty in applying the uncertain “community benefit” standard. The court found that a recreational facility operated for thousands of working women selected by the organization’s trustees and consisting primarily of women employed by one particular corporation qualified under section 501(c)(4):

¹⁴² See 2003 CPE Text, *supra* note 35, at I-4.

¹⁴³ 158 F.2d 272, 276 (6th Cir. 1946).

¹⁴⁴ 316 F.2d 151, 156 (3rd Cir. 1962).

¹⁴⁵ 389 F. Supp. 858 (WD Pa. 1975).

Eden Hall Farm is an institution which has served a broad community need in the sense that Congress intended, that is, that when one segment or slide of the community, in this case, thousands of working women of the Pittsburg and Allegheny County area are served, then the community as a whole benefits.¹⁴⁶

The IRS, however, disagreed. In a revenue ruling explaining why it would not follow the case, the IRS acknowledged that “[t]here is no requirement that a section 501(c)(4) organization provide equal benefits to every member of the community.”¹⁴⁷ The ruling continues:

In the instant case, however, the organization imposed limits on the use of its facility other than those that were inherent in the nature of the facility. By restricting the use of the facility to employees of selected corporations and their guests, the organization is primarily benefiting a private group rather than primarily benefiting the common good and general welfare of the community.¹⁴⁸

The General Counsel Memorandum related to the *Eden Hall Farm* case ruling regretted that it was “nearly impossible” to set guidelines as to how large a benefited group had to be to qualify under section 501(c)(4).¹⁴⁹ As Hill and Mancino observe, “Although the number of persons benefited does not itself determine whether an organizations qualifies for exemption under Section 501(c)(4), it is generally true that qualifying organizations serve purposes that benefit a broad component of the community rather than a specifically delineated membership.”¹⁵⁰

Under the negative test, section 501(c)(4) organizations cannot benefit primarily a private group of citizens.¹⁵¹ The size of the community benefit, however, bears upon the degree of private benefit permitted. A limitation of private benefit applies to both section 501(c)(3) and

¹⁴⁶ 380 F. Supp. at 866. The court quoted the statute in full, including the language regarding “local associations of employees, the membership of which is limited to employees in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.” It did not consider whether this language, by negative implication, disqualified Eden Hills Farms, which served more than a particular municipality.

¹⁴⁷ Rev. Rul. 80-205.

¹⁴⁸ *Id.*

¹⁴⁹ I.R.S. Gen. Couns. Mem. 37675 (Sept., 1978). General Counsel Memorandum are no longer issued. They were documents prepared by the IRS Office of Chief Counsel that “contain the reasons behind the adoption of revenue rulings, private letter rulings, and technical advice memoranda.” *Taxation with Representation Fund v. I.R.S.*, 485 F. Supp. 263 266 (D.D.C. 1980).

¹⁵⁰ Hill & Mancino, *supra* note 5, ¶ 13.02. I read the quoted language to use “member” to mean a contributor-beneficiary, not a legal member under state law.

¹⁵¹ See 1981 CPE Text, *supra* note 20.

section 501(c)(4) organizations, but the source of the doctrine differs for the two subsections. For section 501(c)(3), the IRS has derived the concept from the requirement that a section 501(c)(3) organizations must serve a public rather than private benefit.¹⁵² As a result, as *Better Business Bureau* explains, the presence of private benefit, if substantial in nature, will destroy an organization's section 501(c)(3) exemption.¹⁵³ Any private benefit the organization provides to its members must be only insubstantial.¹⁵⁴

The notion for section 501(c)(4), in contrast, is a "logical extension of the general requirement that social welfare is for the benefit of the general community as a whole."¹⁵⁵ The IRS has interpreted this difference to permit 501(c)(4) organizations to confer greater private benefit than can section 501(c)(3) entities. A section 501(c)(4) organization generally cannot limit its services and benefits to its members;¹⁵⁶ a certain amount of private benefit is permissible, but the organization must remain primarily devoted to social welfare.

The 1981 Continuing Professional Education text tries to elucidate how much private benefit is permissible. It illustrates the distinction between organizations that serve the community and those that serve only their members or some other restrictive class by contrasting revenue rulings involving similar activities.¹⁵⁷ Of the many cases and revenue rulings discussed

¹⁵² See Treas. Reg. § 1.501(c)(3)-1(d)(3); *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989).

¹⁵³ 326 U.S. 279 (1945).

¹⁵⁴ See Andrew Megosh et al., *Private Benefit under IRC 501(c)(3)*, 2001 Continuing Professional Education Text, available at <https://www.irs.gov/pub/irs-tege/eotopich01.pdf>.

¹⁵⁵ 1981 CPE Text, *supra* note 20.

¹⁵⁶ Although the issue is not free from doubt, I do not believe that the meaning of "member" when used by the IRS in the section 501(c)(4) context requires a "member" to have legal rights as a member, such as voting for the members of the board of directors, under state law. The term, I think, refers instead to those who have a right to benefits from the organization and generally pay membership dues, that is, those who are both contributors and beneficiaries. We often see this use of "member" in the section 501(c)(3) context as well. My "membership" in the Los Angeles County Museum of Art gives me no voting rights, but does give me admission to the museum and to various special events. As far as I can tell, membership in AARP does not include any rights to vote, including any right to vote for the board of directors. My husband, who is a member, has never received a ballot from the AARP. (I did not join when I became eligible; I figured one member in the family was enough.) The revenue rulings discussed in the immediately following paragraphs do not state or require the assumption that the members of the organization were legal members with voting rights under state law. Consider also the many HMOs exempt under section 501(c)(4). As the HMO cases discussed *infra* Part VI show, "member" is used to mean "subscriber," not someone with voting rights under state law.

¹⁵⁷ 1981 CPE Text, *supra* note 20, also notes, "In instances where an organization limits its benefits to members, the organization is generally considered not to be operated for social welfare purposes. However, this presumption (inference) may be overcome." It offers Revenue Ruling 66-148 as an example. There, a nonprofit corporation was formed to establish a system for the storage and distribution of water. Any water user could join the organization with payment of an assessment based upon the number of gallons of water pumped from the user's

in the 1981 CPE Text, description of three pairs follows, chosen to elucidate these distinctions, to the extent possible, by contrast.

Revenue Ruling 78-69 concludes that providing bus transportation during rush hours for a suburban community qualified under section 501(c)(4) because the organization was “providing a useful service to all members of the community. . . .Participation in the organization’s affairs is open to all community residents and volunteers carry out its activities.”¹⁵⁸ In contrast, Revenue Ruling 55-311 found that a local association of employees operating a bus system only for its members did not qualify for exemption under section 501(c)(4) because the bus system was “operated primarily for the benefit of the members.”¹⁵⁹

A second contrasting pair of revenue rulings involves television stations. Revenue Ruling 54-349 denied exemption under section 501(c)(4) to a group that furnished television reception on a cooperative basis based on members contracting for services and paying installation fees.¹⁶⁰ In contrast, under Revenue Ruling 62-167, a nonprofit organization formed to provide television for a community as a whole, with membership fees and contributions on a voluntary basis, did qualify.¹⁶¹

The third pair addresses organizations that clean up spills. In *Contracting Plumbers Cooperative Restoration Corp. v. United States*,¹⁶² the Second Circuit denied exemption under both section 501(c)(4) and section 501(c)(6) for an organization that repaired “cuts” in city streets resulting from members’ plumbing activities and for which they were liable. The court found that “each member of the cooperative enjoys . . . economic benefits to the extent he uses and pays for its restoration services.”¹⁶³ The private benefit was such that the organization was not “primarily” devoted to the common good. In contrast, Revenue Ruling 79-316 granted section 501(c)(4) status to an organization with members that was required under state

private well. The organization nonetheless qualified for exemption because its activities benefitted all residents of the community, whether or not they were members or paid any assessments, because the organization’s activities increased the level of the underground water table, to the benefit of all residents of the community. Rev. Rul. 66-148.

¹⁵⁸ Rev. Rul. 78-69.

¹⁵⁹ Rev. Rul. 55-31.

¹⁶⁰ Rev. Rul. 54-349.

¹⁶¹ Rev. Rul. 62-167.

¹⁶² 488 F.2d 684 (2d Cir. 1974).

¹⁶³ 488 F.2d at 687.

law to clean up oil spills in a port city. Because services were available to members and non-members alike, it operated to prevent deterioration of the port to the benefit of the community and thus qualified for exemption under section 501(c)(4).¹⁶⁴

Distinguishing between organizations that provide benefits only to those the organization recognizes as members for the purpose of certain privileges and those that also offer benefits to a large segment of the community is relatively easy. Determining qualification for section 501(c)(4) status in other cases is far more difficult. As Hill and Mancino point out, striking the proper balance between benefit to members and community benefit is particularly challenging with voluntary associations that provide benefits to public employees, such as police officers and firemen.¹⁶⁵ The IRS has rejected section 501(c)(4) status for such associations: “Although the class of employees benefited by the organization consists of police officers engaged in the performance of essential and hazardous public services and there is an incidental benefit provided by the organization to the larger community, the fact remains that the primary benefits from the organization are limited to its members.”¹⁶⁶

Understanding section 501(c)(4)’s border is further complicated by the number of section 501(c) subsections with which it overlaps.¹⁶⁷ That is, the structure of section 501(c) seems

¹⁶⁴ Rev. Rul. 79-316.

¹⁶⁵ Hill & Mancino, *supra* note 5, at ¶ 13.02.

¹⁶⁶ Rev Rul. 81-58. *See also* Police Benevolent Ass’n of Richmond, Va v. United States. 661 F. Sup. 765 (E.D. Va. 1987), *aff’d without opinion*, 836 F.2d 547 (4th Cir. 1987) (denying exemption). To avoid this result, many states have adopted statutory schemes to support volunteer fire departments. These statutes govern funding as well as setting mandatory and automatic eligibility for benefits. Under these statutes, these relief organization may qualify under section 501(c)(3) as lessening the burdens of government. Debra Cowan & Terry Berkovsky, *Volunteer Firefighters’ Relief Organizations: A Second Look*, 2000 EO CPE Text, available at <https://www.irs.gov/pub/irs-tege/eotopicg00.pdf>. These relief organizations also now qualify under section 501(c)(4). In Revenue Ruling 87-126, an association established and maintained by a local government to provide retirements benefits for certain of its firefighters qualified under section 501 (c)(4) because the association was governed by state law and the benefits were funded primarily by state and local governments. The government apparatus demonstrated that the organization’s activities were in the public interest.

¹⁶⁷ The 1981 CPE Text speaks of “overlap” between section 501(c)(4) with sections 501(c)(3), 501(c)(5), 501(c)(6), 501(c)(7), 501(c)(8), 501(c)(9), 501(c)(12), 501(c)(7) and 501(c)(21). It finds that the section 501(c)(3)/(c)(4) overlap is the greatest source of difficulty for the Service. It identifies Rev. Rul. 74-361 as “probably the first instance where the Service publicly conceded that the subparagraphs of section 501(c) are not necessarily mutually exclusive.” 1981 CPE Text, *supra* note 20. A number of examples of bases for exemption overlapping with section 501(c)(4) are discussed in Part VII. As Lloyd Mayer details in his paper, [add cross-reference when available], electric and water cooperatives find exemption under both section 501(c)(4) and section 501(c)(12), thus presenting another overlap.

to call for drawing fine distinctions for its various subsections, but the lines of division both depend on other subsections and blur at the edges. A favorite example involves garden clubs. Revenue Ruling 66-179 describes how garden clubs can qualify under sections 501(c)(3), 501(c)(4), 501(c)(5) or 501(c)(7). In situation 1, the club qualified under section 501(c)(3) because it engaged in educational activities for the public and efforts to beautify roads, thus combating community deterioration. The organization in situation 2 qualified under section 501(c)(4), and not (c)(3), because a substantial part of the organization's activities, but not its primary activity, consisted of social functions for the benefit of its members. The third organization had as its purpose bettering the condition of persons engaged in horticultural pursuits and improving the grade of their products. It thus fell under section 501(c)(5). The fourth organization consisted of amateur gardeners to promote their common interest. Because it was operated exclusively for the pleasure and recreation of its members, it was exempt under section 501(c)(7) as a social club.¹⁶⁸

Later rulings attempt to illuminate further how to balance public and private benefit. In Revenue Ruling 68-14, an organization organized and operated to preserve and develop the beauty of a city was deemed eligible for exemption under section 501(c)(3). Its activities included planting trees in public areas, keeping the city clean, educating the public about tree planting, and encouraging architects and builders to plant trees. The ruling concludes that the organization lessened the burdens of government, educated the public, architects, and builders and combated community deterioration.¹⁶⁹

In contrast, the organization in Revenue Ruling 75-286 was formed by residents of a city block to preserve and beautify that block. The organization also sought to prevent deterioration of the block by, for example, planting trees on public property within the block as well as picking up litter and refuse in the public street. Membership in the organization was restricted to those living on the block or owning property or operating businesses on it. The ruling concluded that the organization's activities did in fact promote social welfare by beautifying and

¹⁶⁸ Rev. Rul. 66-179.

¹⁶⁹ Rev. Rul. 68-14.

preserving public property in cooperation with the local government and that this effort benefits the community as a whole. That its activities consisted of activities traditionally entrusted to government enabled the IRS to overcome the presumption that the organization was organized and operated primarily for the benefit of its members, a conclusion that would have prevented exemption under section 501(c)(4). However, because its efforts were restricted to improving the area adjacent to the residence of its own members and enhanced its members' property rights, it qualified for exemption under section 501(c)(4) and not section 501(c)(3). That is, the organization exhibited too much private benefit in comparison to public benefit to meet the standards of section 501(c)(3).¹⁷⁰

No ruling to my knowledge considers whether, for example, beautification efforts for a neighborhood would qualify under section 501(c)(3) or section 501(c)(4). Much would appear to depend, as elsewhere in section 501(c)(4), on the criteria for membership and the extent to which members benefit from membership. Currently, there are no bright lines. As discussed further *infra*,¹⁷¹ focusing on membership may be a more promising route to reform of section 501(c)(4) than any attempt to define such broad and amorphous concepts such as "community" or "social welfare."¹⁷²

The 1981 Continuing Professional Education text concluded that "'social welfare' is inherently an abstruse concept that continues to defy precise definition. Careful case-by-case analyses and close judgments are still required."¹⁷³ Such may well be the case, but so ill-defined a standard risks administrative discretion that produces inconsistent results.

¹⁷⁰ Rev. Rul. 75-286.

¹⁷¹ See *infra* Part VIII.

¹⁷² I had hoped that social science research on community might be helpful. Such research views the concept of community even more broadly than does the IRS. For example, one recent article described community as follows: "First and foremost, community is not a place, or an organization; nor is it an exchange of information over the Internet. Community is both a feeling and a set of relationships among people. People form and maintain community to meet common needs." David M Chavis & Kien Lee, *What Is Community Anyway*, STANFORD SOC. INNOVATION REV. (March 12, 2015), available at https://ssir.org/articles/entry/what_is_community_anyway.

¹⁷³ 1981 CPE Text, *supra* note 20.

VI. An External View of Section 501(c)(4): Border Control

Rather than trying to make sense of section 501(c)(4) within its own confines, we may have better success viewing section 501(c)(4) as an attempt to protect the boundaries of other subsections, particularly section 501(c)(3). I believe such an approach is useful, although it is a far from perfect perspective, given the frequent overlap between section 501(c)(4) and other subsections. Protecting the border of section 501(c)(3) matters because section 501(c)(3) is the subsection that offers the full complement of tax benefits—deductibility and exemption from income tax for all income, including investment income,¹⁷⁴ as well as exemption from gift and estate tax.¹⁷⁵ As a result, organizations may be tempted to shoehorn themselves into the subsection without carrying out the charitable purposes or adhering to doctrines, such as private benefit, designed to ensure that these organizations serve a public benefit. Moreover, because section 501(c)(3) organizations are by far the most numerous of exempt organizations,¹⁷⁶ abuse of rules applicable to them will inevitably have a disproportionate influence on the sector as a whole.

One key way in which section 501(c)(4) protects the requirements of section 501(c)(3) is by permitting lobbying related to exempt purpose without limit and campaign intervention that is less than the organization's primary activity, in contrast to section 501(c)(3)'s limit on lobbying and prohibition of campaign intervention. Section 501(c)(4) offers a tax-exempt route to such activities. In *Regan v. Taxation with Representation of Washington*, Justice Blackmun concurred with the rest of the Supreme Court that limits on lobbying by section 501(c)(3) organizations were consistent with the First Amendment. He was able to reach this conclusion only be-

¹⁷⁴ Section 4940 does impose a 1-2% tax on the investment income of private foundations. I.R.C. § 4940 (2018).

¹⁷⁵ I acknowledge that the language and requirements of these provisions – sections 170(c), 501(c)(3), 2055, and 2522(a) – are not identical in all respects, but this is not the place for discussions of those differences. See, e.g., Eric M. Zolt, *Tax Deduction for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above*, 63 HASTINGS L.J. 361 (2012); David E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531 (2006); Harvey P. Dale, *Foreign Charities*, 48 TAX LAW. 655 (1995). Section 501(c)(3) status also confers additional federal benefits. See Bazil Facchina, Evan Showell & Jan E. Stone, *Privileges & Exemptions Enjoyed by Nonprofit Organizations: A Catalog and Some Thoughts on Nonprofit Policymaking*, 28 U.S.F. L. REV. 85 (1993). State tax benefits for income, sales, and property taxes often follow from an organization qualifying under section 501(c)(3).

¹⁷⁶ According to the National Center for Charitable Statistics, using April 2016 data, section 501(c)(3) organizations total 1,202,719 and all other nonprofit organizations 363,337. National Center for Charitable Statistic, *Quick Facts About Nonprofits*, available at <http://www.nccs.urban.org/data-statistics/quick-facts-about-nonprofits>.

cause a section 501(c)(3) organization could form a section 501(c)(4) affiliate to enable it to engage in unlimited lobbying in an organization not subject to income tax.¹⁷⁷ In the years after this decision, both the Supreme Court and appellate courts have often relied on Justice Blackmun's concurrence.¹⁷⁸

The state of the law regarding campaign finance changed considerably since Congress established the statutory contours of section 501(c)(4) and the IRS promulgated regulations in 1959 permitting a substantial amount of campaign intervention.¹⁷⁹ Congress enacted the Federal Election Campaign Act in 1974,¹⁸⁰ amended it in the Bipartisan Campaign Reform Act of 2002,¹⁸¹ and enacted section 527 in 1975.¹⁸² All of these statutes require disclosure of campaign donors; section 501(c)(4) organizations, however, need not disclose the source of their donations to campaigns. Thus, while section 501(c)(4) continues to protect the boundaries of section 501(c)(3), it now undermines disclosure that, in my mind, is crucial to our campaign finance law.¹⁸³ However, I leave further discussion of lobbying and campaign intervention to the conference papers that focus on these topics.¹⁸⁴

Section 501(c)(4) to some extent patrols the border of private foundations because no charitable deduction is allowed for contributions to section 501(c)(4) organizations dedicated to charitable grantmaking. If, however, the charitable contribution deduction does not matter to potential donors,¹⁸⁵ either because of the donors' enormous wealth or because the donors will

¹⁷⁷ 461 U.S. 540, 553 (1983) (Blackmun, J., concurring).

¹⁷⁸ See Aprill, *supra* note 51, at 369-72.

¹⁷⁹ See T.D. 6391, 24 Fed. Reg. 5217 (June 6, 1959) (regulation effective retroactive to 1953). See Ellen P. Aprill, *The IRS's Tea Party Tax Row: How "Exclusively" Became "Primarily,"* PACIFIC STANDARD, June 7, 2013, available at <https://psmag.com/news/the-irss-tea-party-tax-row-how-exclusively-became-primarily-59451>.

¹⁸⁰ Pub. L. No. 92-225, 86 Stat. 3 (1972).

¹⁸¹ Pub. L. No. 107-155, 116 Stat. 81 (2002).

¹⁸² Pub. L. No. 93-65, 88 Stat. 2108, 21174 (1975).

¹⁸³ See Aprill, *supra* note 51. See also Roger Colinvaux's paper for this symposium; Roger Colinvaux, *Political Activity Limits and Tax Exemption: A Gordian's Knot*, 34 VA. TAX REV. 1 (2014); Lloyd Hitoshi Mayer, *Nonprofit, Politics and Privacy*, 62 CASE-WESTERN L. REV. 801 (2012). Congress, by its failure to pass legislation requiring disclosure of those who make contributions to section 501(c)(4) organizations for purposes of campaign intervention, clearly takes a view of disclosure different from mine. See Democracy 21, *Summary of Disclose Act*, available at <http://www.democracy21.org/legislative-action/press-releases-legislative-action/summary-of-disclose-act-2/>.

¹⁸⁴ [Add citations to symposium papers on lobbying and campaign intervention]

¹⁸⁵ As David Miller's paper for this symposium discusses, this use of section 501(c)(4) can be especially useful for foreign organizations. [Add cross-reference.] In other cases, a donor's wealth may so exceed income that the charitable contribution deduction will not be available because of limits on the deduction related to the donor's adjusted gross income. See I.R.C. § 170(b) (2018). Various structures structure allow a section 501(c)(4) engaged in

take the standard deduction rather than itemize deductions, this aspect of section 501(c)(4) has little bite. Such donors are free to use the section 501(c)(4) organization to make grants for worthwhile projects without the need to comply with the many restrictions on private foundations, which include tax on investment income, mandatory distributions, and excise taxes on self-dealing and excess business holdings, among others. Grantmaking section 501(c)(4)s have existed for decades.¹⁸⁶

However, such use of section 501(c)(4) organizations may be increasing since the passage of the gift tax exclusion for contributions to section 501(c)(4) organizations. Except for the impact of changes introduced by the 2017 tax legislation, I leave detailed discussion of this phenomenon to other papers in the symposium.

Section 501(c)(4) also protects the boundaries of section 501(c)(3) in connection with specific activities. Consider low income housing. Section 501(c)(4) low income housing organizations play an important role in the provision of low income housing. Much of the development of low income housing relies on the low-income housing credit of section 42.¹⁸⁷ The U.S. Department of Housing and Urban Development calls this credit “the most important resources for creating affordable housing in the United States today.”¹⁸⁸ Private parties make use of this

campaign intervention to establish its social welfare activities with funds that have been deducted as charitable contributions. For example, as practitioners have described to me, donors can set up a private foundation, getting the charitable contribution deduction or donations to it, then, donate funds earmarked for charitable activities from the private foundation to a section 501(c)(4) organization. The private foundation undertakes oversight known as expenditure responsibility for those donated funds. See I.R.C. § 4945(h) (2018). The contributions from the private foundation permit the section 501(c)(4) to use other contributions for lobbying and campaign intervention. Use of section 501(c)(4) organizations can also offer advantages to trusts. As Carlyn McCaffrey has shared with me, the trustee of a trust will receive a distribution deduction for a distribution of trust property to a section 501(c)(4) organization even if a deduction would not have been permitted if the distribution of that property had been made to a section 501(c)(3) organization. Section 642(c) permits the deduction of a trust distribution to section 501(c)(3) organizations only if the distribution can be traced to the gross income of the trust. Email dated March 18, 2018 from Carlyn McCafferty (on file with author).

¹⁸⁶ See Miller and Mayer symposium papers.

¹⁸⁷ I.R.C. § 42 (2018).

¹⁸⁸ Office of Policy Development and Research, U.S. Department of Housing and Urban Development, *Low Income Housing Tax Credits*, available at <https://www.huduser.gov/portal/datasets/lihtc.html>.

credit by setting up joint ventures between for-profit developers and tax-exempt organizations,¹⁸⁹ including section 501(c)(3) and section 501(c)(4) organizations.¹⁹⁰

Low-income housing can be a charitable activity eligible for exemption under section 501(c)(3) in relieving the poor and distressed.¹⁹¹ Revenue Procedure 96-32 established a safe harbor for organizations that provide low-income housing to qualify under section 501(c)(3) rather than under section 501(c)(4).¹⁹² These requirements include percentage requirements for units occupied by residents that qualify as low income, actual occupancy by low-income residents, and affordability by charitable beneficiaries.¹⁹³ Such organizations must also ensure that they do not violate the private inurement and private benefit requirements of section 501(c)(3).¹⁹⁴

Many organizations cannot meet these safe harbors, which serve to preserve the boundaries of section 501(c)(3). They instead achieve exemption under section 501(c)(4),¹⁹⁵ in

¹⁸⁹ Details of these structures and of the low-income housing tax credit program are beyond the scope of this paper. See MICHAEL L. SANDERS, *JOINT VENTURES INVOLVING TAX-EXEMPT ORGANIZATIONS*, ch. 13 (4th ed. 2013); John R. Washlick, BNA Portfolio 478, *Joint Ventures Involving Tax-Exempt Organizations*, Part VIII, *Low Income Housing Partnerships*; BENNETT L. HECHT, *DEVELOPING AFFORDABLE HOUSING: A PRACTICAL GUIDE FOR NONPROFIT ORGANIZATIONS* 246 (3d Ed., 2006).

¹⁹⁰ The IRS allocates federal tax credits for low income housing to state housing credit agencies based on each state's population. Section 42(h)(5) requires that each year, a state must set aside a minimum of 10 percent of its total credit ceiling exclusively for projects involving qualified nonprofit organizations. A qualified nonprofit organization for these purposes can be either a section 501(c)(3) or 501(c)(4). I.R.C. § 42(h)(5)(C)(i) (2018).

¹⁹¹ See Rev. Rul. 67-138, Rev. Rul. 70-585, and Rev. Rul. 76-408.

¹⁹² Rev. Proc. 96-32.

¹⁹³ Rev. Proc. 96-32, Sec. 3. For example, to qualify under section 501(c)(3), a low income housing organizations must establish for "each project that (a) at least 75 percent of the units are occupied by residents that qualify as low-income; and (b) either at least 20 percent of the united are occupied by residents that also meet the very-low income limit for the area or 40 percent of the units are occupied by residents that also do not exceed 120 percent of the area's very low-income limit." *Id.* The 75 percent requirement is more stringent than the low-income-housing tax credit itself, which requires that either 20 percent or more of the residential units are both rent-restricted and occupied by individual whose income is 50 percent or less of area median gross income or that 40% or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 60% or less of area median gross income. I.R.C. § 42(g)(1)(A). If the safe harbor of Rev, Proc. 96-32 is not satisfied, an organization may demonstrate that it relieves the poor and distressed by surrounding facts and circumstances. The Revenue Procedure lists factors to be considered. *Id.* at Sec. 4. The Revenue Procedure also lists other possible bases for organizations that provide low income housing to qualify under section 501(c)(3), including combatting community deterioration, lessening the burdens of government, and lessening neighborhood tensions. *Id.*, at § 3.

¹⁹⁴ I.R.C. § 501(c)(3) (2018).

¹⁹⁵ Koulisch, *supra* note 17, at 6, Table 2, Table 2, gives the number of section 501(c)(4) housing and community developments as 978. He also identifies 315 organizations in the "other" category of the 2012 NCCS Core File, 2012 as belong in the category of housing and shelter under the Major National Taxonomy of Exempt Entities. *Id.* at 16, Table 7.

part because of section 501(c)(4)'s less stringent private benefit requirements. Thus, the existence of section 501(c)(4) advances an important public purpose without stretching or warping the boundaries of section 501(c)(3), in particular its strict application of the private benefit doctrine.

The ongoing controversy and uncertainty about whether prepaid medical plans, particularly HMOs, can qualify for exemption under section 501(c)(3) also demonstrates how the IRS deploys section 501(c)(4) for border control.¹⁹⁶ The IRS has stated that it considers exemption under section 501(c)(4) for prepaid medical service plans to be an exception to the "general rules that a social welfare organization may benefit its members so long as the principal beneficiaries remain the community as a whole."¹⁹⁷ It has further observed that the "first prepaid medical plans were recognized as exempt during the great depression" and that it would "not as a rule overturn longstanding positions favorable to a taxpayer where subsequent legislative enactments have failed to do so. This is particularly true where such action could have adverse impact on a large proportion of U.S. citizens."¹⁹⁸ Thus, the IRS continues to maintain that HMOs are not eligible for exemption under section 501(c)(3), while begrudgingly accepting their exemption under section 501(c)(4).

The replacement of the charitable care test by the community benefit test as the basis for hospital exemption under section 501(c)(3) put pressure on this IRS position.¹⁹⁹ Revenue Ruling 69-545 was the first piece of IRS guidance to apply the new test:

The promotion of health, like the relief of poverty and the advancement of religion, is one of the purposes of the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct ben-

¹⁹⁶ Kouish, *supra* note 17, at 6. Table 2 gives the number of section 501(c)(4) organization that are health providers and insurers at 459, of which 314 file Form 990.

¹⁹⁷ 1981 CPE Text, *supra* note 20.

¹⁹⁸ 1981 CPE Text, *supra* note 20.

¹⁹⁹ The arrival of Medicare and Medicaid in 1965 led to the community benefit standard replacing the charitable care test. See Daniel M. Fox and Daniel C. Schaffer, *Tax Administration as Health Policy: Hospitals, the Internal Revenue Service, and the Courts*, 16 J. HEALTH POL., POL'Y & LAW 251 (1991).

efit from the its activities does not include all members of the community, such as indigent members of the community, provided that the class is not so small that its relief is not of benefit to the community.²⁰⁰

As the ruling made clear, in the case of hospitals, operating an emergency open to all persons regardless of ability to pay is of particular importance in satisfying this community benefit standard.²⁰¹

Applying the standard of Revenue Ruling 69-545, the Tax Court rejected the Service's position that the HMO in *Sound Health Association v. Commissioner*²⁰² did not qualify for exemption under section 501(c)(3).²⁰³ The HMO in the case operated an outpatient clinic that treated both members and non-members on a fee-for-service basis.²⁰⁴ Moreover, it provided emergency care to whoever needed it, regardless of ability to pay, within the clinic's capabilities. The court concluded that the Sound Health HMO was like the hospital that satisfied the requirements for exemption under section 501(c)(3) in Revenue Ruling 69-545, by operating an emergency room open to all regardless of membership status or ability to pay.²⁰⁵ In addition, the HMO had established a research program, an education program, and a fund to help subsidize membership for person who could not make the requirement monthly payments.²⁰⁶ The court pointed to the organization's particular form of membership as extending, for all practical purposes, to "the class of member of the community itself."²⁰⁷

²⁰⁰ Rev. Rul. 69-545.

²⁰¹ *Id.*

²⁰² 71 T.C. 158 (1978).

²⁰³ The HMO in *Sound Health* operated under the staff model, in that health care was provided by the entity itself through its own salaried staff and not indirectly through agreements with physician or other entities, a fact important to later developments. *Id.*

²⁰⁴ Because the issue of membership is so important in the context of section 501(c)(4), I note that those referred to as "members" of HMOs do not possess legal rights as members under state law.

²⁰⁵ 71 T.C. at 191.

²⁰⁶ 71 T.C. at 184.

²⁰⁷ 71 T.C. at 185.

Eventually, the IRS acquiesced to the result in *Sound Health*.²⁰⁸ In a General Counsel Memorandum, however, it developed, a 14-factor test for an HMO to qualify for exemption under section 501(c)(3) rather than 501(c)(4).²⁰⁹ That is, as it did with the revenue procedure applicable to low-income housing, the IRS established an administrative test to define and maintain the boundaries between section 501(c)(3) and section 501(c)(4).²¹⁰ Factors included provision of services to nonmembers on a fee-for-service basis, care and reduced rates for the indigent, a meaningful subsidized membership program, and a board of directors broadly representative of the community.²¹¹ The General Counsel Memorandum listed additional factors for membership organizations, including “a membership composed of both groups and individuals where such individuals compose a substantial portion of the members” and “an overt program to attract individuals to become members.”²¹² A leading textbook believes that “[p]articularly targeted were contract model HMOs that arranged for the delivery of health care through agreements with physicians or other entities but did not actually provide medical services using their own staff.”²¹³

Overruling the Tax Court, the Third Circuit in *Geisinger Health Plan v. Commissioner*,²¹⁴ denied exemption under section 501(c)(3) to an HMO that served only its paying subscribers, even if it intended to establish a subsidized dues program. The court found that the HMO did not provide any health care services itself and did not ensure that those who are not its subscribers had access to health care or information about health care.²¹⁵ The appellate court concluded that the HMO could not demonstrate that “it benefits anyone but its subscribers.”²¹⁶ A subsidized dues program did not in and of itself sufficiently benefit the community to qualify for exemption under section 501(c)(3).²¹⁷ The appellate court reached this decision even though

²⁰⁸ 1981-1 C.B. 2.

²⁰⁹ I.R.S. Gen. Couns. Mem. 39828 (Sept., 30, 1987).

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Id.*

²¹³ Fishman, Schwarz, Mayer, *supra* note 104, at 305.

²¹⁴ 985 F.2d 1210 (3rd Cir. 1993). Its HMO followed the individual practice association, not staff, model. *Id.*

²¹⁵ 985 F.2d at 1219.

²¹⁶ *Id.* at 1218.

²¹⁷ The court declined to reach the question of whether the HMO could be exempt under section 501(c)(3) not standing alone but as an integral part of the health care system. It remanded the case to the Tax Court for clarification of that issue. 985 F.2d at 1220. The Tax Court held on remand that the HMO did not meet the integral part

“the organizational structure of the Geisinger system was mandated by state licensing requirements” and it and its affiliated entities “satisfied most of the Service’s criteria for community benefit.”²¹⁸

*IHC Health Plans, Inc. v. Commissioner*²¹⁹ also denied exemption under section 501(c)(3) to three HMOs formed as part of an integrated delivery system. The court articulated the test for exemption under section 501(c)(3), in the context of health-care providers, as whether the taxpayer operates “*primarily for the benefit of the community*.”²²⁰ According to the court, “an organization cannot satisfy the community-benefit requirement based solely on the fact that it offers health-care services to all in the community in exchange for a fee. . . . Rather, the organization must provide some additional ‘plus.’”²²¹ It not very helpfully explained that this additional benefit

must either further the function of government-funded institutions or provide a service that would not likely be provided within the community but for the subsidy.

Further, the additional public benefit conferred must be sufficient to give rise to a strong inference that the public benefit is the *primary purpose* for which the organization benefits.²²²

The petitioners failed this test. The court also denied exemption under section 501(c)(3) under the integral part theory. It rejected this basis for exemption on the grounds that petitioners did not function to further the “parent” organization because only 20% of the physicians who provided services to the HMO came from physicians employed by the parent organization. Therefore, petitioner did not function solely to further the exempt purposes of the parent entity.²²³

doctrine because it failed to establish that its activities would not have been considered an unrelated trade or business if carried on by the related entities. 100 T.C. 904. The Third Circuit affirmed, but on the grounds that the HMO’s affiliation with other entities did not increase the portion of the community for which it promoted health. 30 F.3d 494.

²¹⁸ Fishman, Schwarz, Mayer, *supra* note 104, at 305. They conclude that “the Third Circuit was unwilling to grant exempt status to a stand-alone entity that performed no health services itself.” *Id.*

²¹⁹ 325 F.3d 1188 (10th Cir. 2003).

²²⁰ 325 F.3d at 1197 (emphasis in original).

²²¹ *Id.*

²²² 325 F.3d at 1198 (emphasis in original).

²²³ 325 F.3d at 1204.

Thus, the current state of affairs regarding HMOs is that section 501(c)(4), with its less rigid requirements, protects section 501(c)(3) from pressure to loosen its requirements. As the Joint Committee of Taxation has written, HMOs “often obtain exempt status under section 501(c)(4) rather than under section 501(c)(3) because of the private benefit concerns and the difficulty in satisfying the charitable purpose requirement of section 501(c)(3).”²²⁴

Nonetheless, in all of these categories of activities, the availability of section 501(c)(4) has operated to safeguard the limits of section 501(c)(3) and to defend the integrity of section 501(c)(3). Such safeguards have often, but not always, occurred through administrative action by the IRS. For all these categories of activities, section 501(c)(4) has operated to safeguard the limits of section 501(c)(3) and to defend the integrity of section 501(c)(3). In the case of lobbying and campaign intervention, the safeguards appear in the section 501(c)(3) statute itself. For low income housing and HMOs, the IRS has announced boundaries between section 501(c)(3) and 501(c)(4), although courts have also played a role in the latter. Expansion of section 501(c) grantmaking activities may lead to Congressional or administrative action.

VII. Section 501(c)(4) Border Skirmishes

The fragmented nature of section 501(c)(4) can reveal fault lines in tax-exemption. When identified, these fault lines can shift the exemption landscape in two different ways. First, they can trigger new bases for exemption, whether under section 501(c)(4) or section 501(c)(3). Second, they can prompt clarification of the bases for denying exemption under those and other provisions regarding tax-exempt organizations. That is, in addition to reinforcing the borders of various provisions of section 501(c), particularly section 501(c)(3), section 501(c)(4) plays an important role in changing these borders. Once the borders are changed, section 501(c)(4) renews its border patrol function, now patrolling different borders. We can see these changes in revenue rulings, judicial decisions, and statutory changes.

Sometimes the IRS itself changes the borders between the subsections of 501(c). Revenue Ruling 67-294, with little analysis or discussion, recognized as exempt under section

²²⁴ STAFF OF THE JOINT COMMITTEE ON TAXATION, HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS, JCX-20-05, April 2006, at 116 n. 388.

501(c)(4) a nonprofit organization created to make loans to business entities in order to alleviate unemployment in an economically depressed area when similar loans were not available from commercial sources.²²⁵ Fewer than ten years later, Revenue Ruling 74-587 found exempt under section 501(c)(3) an organization that provided “funds and working capital to corporations or individual proprietors who are not able to obtain funds from conventional commercial sources because of the poor financial risks involve in establish and operating enterprises in those communities.”²²⁶ The ruling did not discuss private benefit in any detail. In fact, it stated, “Although some of the individuals receiving financial assistance in their business endeavors under the organization’s may not themselves qualify for charitable assistance as such, that fact does not detract from the charitable character of the organization’s program, which included relief of poverty, the lessening of neighborhood tensions, and the combating of community deterioration.”²²⁷

Court decisions also push the IRS to shift these borders. Revenue Ruling 78-131 found an organization with the purpose of developing and encouraging an interest in arts by holding a community art show exempt under section 501(c)(4). Even though the organization received income from exhibitors’ fees, sales commissions, and catalogue sales, the ruling emphasized that the art show was conducted in a noncommercial manner. It included works of amateurs, set aside space for students, and relied on volunteers.²²⁸ In *Goldsboro Art League v. Commissioner*,²²⁹ however, the Tax Court rejected the IRS’s argument that commerciality along with the private benefit afforded artists whose works were exhibited prevented exemption under section 501(c)(3) for an organization that, among other educational activities, operated two galleries showing works chosen by a jury and for their representation of modern trends. According to the Tax Court, “Exhibiting an artist’s more daring works in a part of the country where there

²²⁵ Rev. Rul. 67-294.

²²⁶ Rev. Rul. 74-587.

²²⁷ Of course, we do not know whether the organization in Revenue Ruling 67-294 sought section 501(c)(3) status and was rejected or whether it sought only section 501(c)(4) status. For a discussion of whether Congress intended some categories of 501(c) to be exclusive, see Lloyd Mayer’s piece in this issue [cross-reference to be added].

²²⁸ Rev. Rul. 78-131.

²²⁹ 75 T.C. 337 (1980).

are no nearby art museums or galleries illustrates that petitioner's purpose is primarily to educate rather than sell."²³⁰ The court also found the activities with respect to the gallery sales incidental to its other educational activities.²³¹

The Goldsboro Art League engaged in far wider range of activities, including sponsoring art classes and art demonstrations, than did the organization in Revenue Ruling 78-131. Thus, the contrast here is not as sharp as that between the two economic development rulings. Nonetheless, *Goldsboro Art League* establishes that art sales by a community art organization do not automatically prevent exemption under either section 501(c)(4) or section 501(c)(3).

The most important examples of border skirmishes, however, involve activities that produced statutory changes – veterans' organizations, homeowners' associations, amateur sports, and credit counseling.

Until 1972, war veterans' organizations, like other veterans' organizations, were recognized as exempt under section 501(c)(4). These war veterans' associations often formed subsidiaries recognized as exempt as social clubs under section 501(c)(7), and a number of these veterans' associations also offered various kinds of insurance to their members and their members' dependents.²³²

The Tax Reform Act of 1969 extended the unrelated business income tax to all exempt organizations, including social welfare organizations and social clubs.²³³ The Joint Committee explained that this change corrected "an injustice by which some tax-exempt organizations are subjected to tax on their business income while others remain tax-free with respect to the same sort of business income."²³⁴ These changes prompted Congressional concern regarding taxation of insurance for veterans, a concern that was heightened by a provision in the Tax Re-

²³⁰ 75 T.C. at 344.

²³¹ 75 T.C. at 345.

²³² See INTERNAL REVENUE SERVICE, TAX GUIDE FOR VETERANS' ORGANIZATIONS 3, available at <https://www.irs.gov/pub/irs-pdf/p3386.pdf>.

²³³ Pub. L. No. 91-172 (1969), adding § 519(c)(19) to the Internal Revenue Code of 1954, as amended.

²³⁴ STAFF OF THE JOINT COMMITTEE ON TAXATION AND SENATE FINANCE COMMITTEE, SUMMARY OF H.R. 13270, THE TAX REFORM ACT OF 1969 27 (Aug. 18, 1969), available at <http://www.jct.gov/s-61-69.pdf>.

form Act of 1969 that provided a specific exemption from the tax for insurance income of section 501(c)(8) fraternal societies,²³⁵ but made no mention of insurance provided by veterans' organizations.

In 1972, Congress, still troubled about the taxation of insurance activities of war veterans' organizations,²³⁶ passed section 501(c)(19), a new subsection for veterans' organizations, and section 512(a)(4), which exempted certain insurance benefits for veterans and their dependents from the unrelated business income tax.²³⁷ At the time of its enactment, at least 75% of the members of a section 501(c)(19) organization had to be past or present members of the armed forces; and substantially all of the other members²³⁸ had to be cadets or the spouses, widows or widowers of either past and present members of the Armed Forces or of cadets.²³⁹

Congress amended the provision in 1982 and 2003 to relax membership requirements and broaden the purposes of war veterans organizations.²⁴⁰ Under current law, organizations exempt under section 501(c)(19) must be organized in the United States or its possessions, have at least 75% of its members be past or present members of the armed forces and have substantially all of its remaining members be either cadets or the spouses, widows, widowers,

²³⁵ INTERNAL REVENUE SERVICE, TAX GUIDE FOR VETERANS' ORGANIZATIONS, *supra* note 232, at 3.

²³⁶ Internal Revenue Service, *Veterans' Organizations*, 1986 EO CPE Text, available at <https://www.irs.gov/pub/irs-tege/eotopicp86.pdf>.

²³⁷ P.L. No. 92-418, 86 Stat. 656 (1972). These provisions were retroactive to January 1, 1970. Congress passed another subsection for veterans, section 501(c)(23), 1982. P.L. No. 97-248. It exempts organizations organized prior to 1880, more than 75% of the members of which are past or present members of the Armed Forces, and the primary purpose of which is provide insurance and other benefits to veterans and their dependent. "This legislation was proposed on behalf of the Army Mutual Aid Association and the Navy Mutual Aid Association. It is broader than IRC 501(c)(19) in that the membership requirements are more lenient. It is limited in application, however, since it applies only to organizations created before 1880. The Army and Navy Mutual Aid Societies are the only organizations known to qualify under this section." Internal Revenue Manual § 7.25.19.9. Brice S. McKeever, Nathan E. Dietz & Saunji D Fyffe, *THE NONPROFIT ALMANAC* (9th ed. 2016) Table 1.1, however, give the number of section 501(c)(23) organizations registered and filing Form 990 as 3.

²³⁸ Based on legislative history, "substantially all" for this purpose means 90%. S. Rept. No. 1082, 92d Cong., 2d Sess. (1972).

²³⁹ Internal Revenue Manual § 7.25.19.2; Internal Revenue Service, *Veterans Organizations*, 1999 EO CPE Text, available at <https://www.irs.gov/pub/irs-tege/eotopicj99.pdf>.

²⁴⁰ Military Family Tax Relief Act, Pub. L. No. 97-248, 96 Stat. 640. The 1982 amendment deleted requirement that 75% be war veterans, and the 2003 Act allowed ancestors and lineal descents to be part of the veteran base.

ancestors or lineal descendants of past or present members of the U.S. Armed Forces or of cadets.²⁴¹ Congress has permitted section 501(c)(19) organizations to have a broad range of purposes. Exempt purposes include providing entertainment, care, and assistance to hospitalized veterans or members of the Armed Forces, providing insurance benefits, and providing social and recreational activities for members.²⁴²

The most recent edition of the Nonprofit Almanac gives the number of registered 501(c)(19) organizations in 2015 as 29,588 and the number reporting to the IRS as 8,338.²⁴³ Organizations exempt under section 501(c)(19) are “unique in the tax-exempt sector.”²⁴⁴ They are exempt from income tax, contributions to them may be deductible,²⁴⁵ and some are permitted to set aside amounts to provide insurance for members. Moreover, they can engage in lobbying and campaign intervention without limit.²⁴⁶

Despite all these advantages, however, veterans’ organizations today continue to be recognized under a number of other subsections of 501(c).²⁴⁷ In particular, the enactment of section 501(c)(19) did not end the use of section 501(c)(4)’s in this area.²⁴⁸ Koulisch lists the

²⁴¹ Section 501(c)(19) (2018).

²⁴² Treas. Reg. § 1.501(c)(19)-1(c). Other permitted purposes include promoting social welfare, perpetuating the memory of veterans and comforting their survivors, sponsoring or participating in patriotic activities, and conducting programs for religious, charitable, scientific literary or educational purposes. *Id.*

²⁴³ Brice S. McKeever, Nathan E. Dietz & Saunji D Fyffe, THE NONPROFIT ALMANAC Table 1.1 (9th ed. 2016).

²⁴⁴ TAX GUIDE FOR VETERANS’ ORGANIZATIONS, *supra* note 232, at 3.

²⁴⁵ Under section 170(c)(3), contributions are deductible if made to a war veterans organization. See I.R.C. 170(c)(3) (2018). That is, Congress did not amend section 170(c)(3) when it made other changes regarding veterans’ organizations. To be a war veterans’ organization, the organization must satisfy the original definition for section 501(c)(19) organizations – at least 90% of all members must be war veterans and substantially all of the other members must be veterans, cadets, or spouses, widows, or widowers of war veterans, veterans or cadets. The organization must also be organized for the more limited purposes allowed in the 1972 legislation. See Rev. Rul. 84-140; Internal Revenue Manual § 7.25.19.6. Contributions to section 501(c)(4) organizations that meet these requirements are also deductible. *Id.*

²⁴⁶ The taxpayer argued in *Regan v. Taxation with Representation*, 461 U.S. 540 (1983), that permitting deduction along with unlimited lobbying for veterans’ organizations but not other tax-exempt organizations violated the equal protection clause. The Court rejected this argument, finding that it was not irrational for Congress to subsidize lobbying by veterans’ associations in recognition of their service to our country. 461 U.S. at 550.

²⁴⁷ TAX GUIDE FOR VETERANS’ ORGANIZATIONS, *supra* note 232, at 3, lists the following: sections 501(c)(2), 501(c)(4), 501(c)(7), 501(c)(8), 501(c)(10), 501(c)(19) and 501(c)(23). Including charities exempt under section 501(c)(3) that aid veterans, GuideStar gives the total number of organizations devoted to veterans as more than 45,000. Of this 45,000, 65% are posts or organizations such as the American Legion or VFW and 81% are charities. GuideStar, *U.S. Veterans Organizations by the Numbers* (November 2015), available at <https://www.guidestar.org/downloadable-files/us-veterans-organizations.pdf>.

²⁴⁸ The special UBIT exception for insurance income, however, applies only to section 501(c)(19) organizations. See TAX GUIDE FOR VETERANS’ ORGANIZATIONS, *supra* note 232, at 37-38.

number of section 501(c)(4) organizations registered as military and veterans' organizations as 6,365 and the number filing Form 990 as 1,102.²⁴⁹ In particular, "an organization that cannot meet the membership percentage test of IRC 501(c)(19) but is primarily engaged in activities that promote social welfare, such as providing assistance to needy and disabled veterans and/or promoting patriotism, can qualify for IRC 501(c)(4)."²⁵⁰ Thus, section 501(c)(4) now protects the boundary of section 501(c)(19).

Other new code provisions have been enacted as a result of difficulties with the application of section 501(c)(4). Qualification of homeowners' and tenants' associations under section 501(c)(4) proved to be a frequent problem prior to congressional intervention in 1976. Revenue Ruling 74-99, for example, modified an earlier ruling, Revenue Ruling 72-102, which had stated that a housing development could constitute a community. The later ruling explained that to overcome the presumption of being organized for its members, a homeowners' association must show that it serves a community bearing a reasonably recognizable relationship to an area ordinarily identified as governmental, must not conduct activities directed to the exterior maintenance of private residences, and must maintain common areas or facilities for the use and enjoyment of the general public.²⁵¹

These requirements set a high bar.²⁵² Congress thus enacted section 528 as part of the Tax Reform Act of 1976²⁵³ "because many homeowner's associations found it difficult to meet the requirements under IRC 501(c)(4)."²⁵⁴ Congress concluded that it would not be appropriate

²⁴⁹ Koulisch, *supra* note 17, at 6.

²⁵⁰ 2003 CPE Text, *supra* note 35, at I-22.

²⁵¹ Rev. Rul. 74-99. A later revenue ruling, Rev. Rul. 80-63, discusses additional issues raised by Rev. Rul. 74-99. It states, for example, that "if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled and restricted to member of the community, then it may satisfy the requirement of serving a community." *Id.*

²⁵² Nonetheless, Koulisch, *supra* note 17, at 6, Table 2, gives the number of homeowner and tenant association registered with the IRS under section 501(c)(4) as 1,891 and the number filing Form 990 as 988; he separately lists housing communities and developments, with 978 registered and 819 filing Form 990. The organizations also sometimes seek exemption as section 501(c)(7) social clubs. 2003 EO CPE at I-12.

²⁵³ Sec. 2101 of the Act., Pub. L. No. 94-455, 90 Stat. 1525, adding § 528 to the Internal Revenue Code of 1954, as amended.

²⁵⁴ 2003 CPE Text, *supra* note 35, at I-20.

to tax the revenue of an associations of homeowners who act together if an individual homeowner acting alone would not be taxed on the same activity.²⁵⁵ Homeowners acting alone, however, would face tax on any investment income, and Congress required homeowners associations to do the same.²⁵⁶ That is, unlike the case with veterans' organizations, Congress treated homeowners associations as a conduit for and a pooling of individual homeowners and subject to tax on that basis.²⁵⁷

A homeowners' association may elect to be exempt under section 528. If assessments and dues are used for the maintenance and improvement of association property, the provision exempts from income tax any dues and assessments received by a qualified homeowners' association that are paid by property owners who are members of the association.²⁵⁸ Sixty percent or more of the association's gross income must consist of amounts received as membership dues, fees, and assessments from owners of residential units or residences, and ninety percent or more of the associations' expenditures must be for the acquisition, construction, management, maintenance, and care of association property.²⁵⁹ The provisions of section 528 permit homeowners' associations to exclude exempt function income from gross income.²⁶⁰ Other income, such as investment income and fees from non-members to use facilities, is taxed at a flat 30% rate.²⁶¹ As discussed in Part VIII of this article, although section 501(c)(4) organizations must offer more community benefit than homeowners' associations, a somewhat similar approach may be appropriate for section 501(c)(4) organizations that offer benefits to members.

Compared to section 501(c)(3), section 501(c)(4) has less stringent requirements, and organizations unable to qualify for exemption under section 501(c)(3) often turn to section 501(c)(4) instead.²⁶² As the cases of veterans' organizations and homeowners' associations

²⁵⁵See STAFF OF THE JOINT COMMITTEE ON TAXATION, HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS, *supra* note 224, at 28-29.

²⁵⁶ House Report No. 94-658, 94th Cong., 2d Sess. H.R. 10612 (reproduced in 1979-3 C.B. 373).

²⁵⁷ For a discussion of pooling as one theory underlying methods of taxation, see Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They the Next "Loophole"*, 6 FIRST AMENDMENT L. REV. 41 (2007).

²⁵⁸ I.R.C. § 528(d) (2018).

²⁵⁹ See I.R.C. § 528(c) (2018).

²⁶⁰ IRS, Homeowners' Associations, available at <https://www.irs.gov/charities-non-profits/other-non-profits/homeowners-associations>.

²⁶¹ See I.R.C. § 528(b) (2018).

²⁶²See Koulisch, *supra* note 17, at 3.

demonstrate, the requirements of section 501(c)(4) proved too strict for these particular types of organizations, and Congress responded with more generous provisions.

Congress has also acted in situations regarding potential overlap of section 501(c)(3) and section 501(c)(4). In 1976, Congress amended section 501(c)(3) to include organizations “to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment.)”²⁶³ According to the Joint Committee on Taxation, one of the purposes of this addition was to address the “confusion and inequity for amateur sports organizations” under prior law.²⁶⁴ Before the amendment organizations fostering national or international sports competition could qualify under section 501(c)(4) or section 501(c)(6), but not as educational or charitable organizations under section 501(c)(3).²⁶⁵

Although it was intended as a fix, Congress quickly came to view the facilities and equipment prohibition as unsatisfactory.²⁶⁶ In 1982, Congress enacted section 501(j), retroactive to 1976, under which the facilities and equipment prohibition did not apply to “qualified organizations.”²⁶⁷ A qualified organization under the provision is “any organization organized and operated exclusively to foster national or international amateur sports competition if such organization is also organized and operated primarily to conduct national or international competition in sport or to support and develop amateur athletes for national or international competition in sports.”²⁶⁸

Thus, the amendment to section 501(c)(3) and the addition of section 501(j) expanded the number of amateur athletic organizations that can look to section 501(c)(3) instead of

²⁶³ Tax Reform Act of 1976, Pub. L. No. 94-455, § 1313, 90 Stat. 1520, 1730 (1976).

²⁶⁴ STAFF OF JOINT COMM. ON TAX’N, 94TH CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, at 423. The Joint Committee further explains that the restriction on provision of athletic facilities or equipment “is intended to prevent the allowance of these benefits for organizations which, like social clubs, provide facilities and equipment for their members.” *Id.*

²⁶⁵ See, e.g., Rev. Rul. 70-4.

²⁶⁶ Hill & Mancino, ¶ 3.09[2], *supra* note 6, quote 128 Cong. Rec. S8919 (July 22, 1982): “[T]his statute has caused tremendous financial problems for the amateur sports world. . . . Many of the development drives that assist and prepare our Olympic athletes and other national and regional amateur sports organizations are at a standstill simply because it is necessary for many of these organization to provide training facilities and equipment and they cannot receive tax exempt status under the current interpretation.”

²⁶⁷ Tax Equity and Fiscal Responsibility Act of 1984, Pub. L. No. 98-369, § 286(a), adding section 501(j) to the Internal Revenue Code of 1954, as amended.

²⁶⁸ The statute also provides that a qualified amateur organization would not fail to qualify under section 501(c)(3) “merely because its membership is local or regional in nature.” Section 501(j)(1)(B) (2018).

501(c)(4) for exemption. That is, in this case, Congressional clarification expanded, rather than reduced, the number of organizations that could qualify under section 501(c)(3). Even so, amateur athletic associations may not satisfy section 501(c)(3) and continue to qualify for exemption under section 501(c)(4). Koulish reports that, in the category of sports and recreation, 8,265 organizations have filed for exemption under section 501(c)(4) and 1,557 file Form 990s.²⁶⁹ Both the governing bodies of international soccer and the Olympics are exempt as foreign section 501(c)(4) organizations.²⁷⁰ The United States Olympic Committee, in contrast, is exempt under section 501(c)(3).²⁷¹

Credit counseling is another area in which Congress, responding to judicial decisions and perceived abuses, has intervened to clarify the border between section 501(c)(3) and 501(c)(4). During the 1960's the IRS took the view that credit counseling organizations rarely qualified under section 501(c)(3). To qualify for exemption under 501(c)(3), they needed, for example, to help the indigent without charge.²⁷² Credit counseling organizations without such programs could be exempt only under section 501(c)(4).²⁷³ In 1978, however, the court in *Consumer Credit Counseling Service of Alabama v. United States* reversed the IRS revocation of exemption under section 501(c)(3) of a number of credit counseling organizations.²⁷⁴ The court held that the organizations, whose services were not limited to low-income individuals and their families were "educational because they instruct the public on subjects useful to the individual and beneficial to the community."²⁷⁵

In the 2000's, the IRS, having seen an increase in exemption applications for such organizations and an accompanying increase in abuse, undertook a new program of enforcement.

"[B]y 2005, the IRS had a substantial portion of the nonprofit credit counseling 'industry' under

²⁶⁹ Koulish, *supra* note 17, at 6, Table 4.

²⁷⁰ Koulish, *supra* note 17, at 6. A GuideStar search, <https://www.guidestar.org/search>, gives the following: For the International Olympic Committee, gross receipts of \$3,557,087,000, and assets of \$3,185,106,000; for the Federation Internationale de Football Association, gross receipts of \$555,721,582 and assets of \$3,351,899,816.

²⁷¹ United States Olympic Committee, 2016 Form 990, *available at* <https://www.guidestar.org/FinDocuments/2016/131/548/2016-131548339-0e292507-9.pdf>.

²⁷² *See, e.g.*, Rev. Rul. 69-441.

²⁷³ *See, e.g.*, Rev. Rul. 65-299.

²⁷⁴ 78-2 U.S.T.C. 9660 (DDC. 1978).

²⁷⁵ *Id.*

review either when these organizations filed for recognition of exemption or by audit.”²⁷⁶ The IRS released documents to provide a legal framework for determining the exempt status of such organizations.²⁷⁷ The Commissioner of the IRS testified on the issue before the Subcommittee on Oversight of the House Ways and Means Committee in 2003, before the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs in 2004, and before the Senate Finance Committee in 2005.²⁷⁸

In 2006, as part of the Pension Protection Act, Congress enacted a new subsection of section 501, section 501(q), containing a special set of rules for credit counseling organizations.²⁷⁹ Whether applying for exemption under section 501(c)(3) or under 501(c)(4), the organization must comply with a number of requirements regarding its services, its charges, the composition of its board, its customers, its relationship with related entities, and revenue from debt management plans. A credit counseling organization seeking exemption under section 501(c)(4), unlike other section 501(c)(4) entities, must apply for recognition of exemption, as prescribed in regulations. Additional requirements apply to a credit counseling organization seeking exemption under section 501(c)(3), including a prohibition on soliciting contributions from consumers while they receive services from the organization and limits on the percentage of revenue derived from payments by consumers.²⁸⁰

As all agree, the area occupied by section 501(c)(4) is both broad and uncertain. Inevitably, questions arise related to the boundaries of not only section 501(c)(4) itself but other provisions as well. In some cases, these border skirmishes have resulted in both administrative and congressional action and may do so again in the future. If use of section 501(c)(4) organizations as grantmaking entities that avoid the strictures applicable to private foundations becomes

²⁷⁶ Hopkins, *supra* note 6, at 205. See Hill & Mancino, *supra* note 5, 2017 Cumulative Supplement No. 1, at ¶ 3.03[7], describe in detail the background leading up to the 2006 statutory provisions regarding credit counseling organizations.

²⁷⁷ CCA 200431023 (July 13, 2004); CCA 20062001 (May 9, 2006).

²⁷⁸ See Fred Stokeld, *IRS Taking Aim at Abusive Credit Counseling Outfits, Everson Says*, 43 EXEMPT ORG. TAX REV. 26 (2004); Written Testimony of Mark Everson, United States Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, Hearing on March 24, 2004, available at <https://www.irs.gov/pub/irs-tege/metestimony3-24-2004.pdf>; Fred Stokeld, *EO Reform Proposals Considered at Finance Committee Hearing*, 48 EXEMPT ORG. TAX REV. 127 (2005).

²⁷⁹ Pub. L. No. 109-280, Title XII, § 1220(a), 120 Stat. 780 (Aug. 17, 2006), adding § 501(q) to the Internal Revenue Code of 1986, as amended.

²⁸⁰ See I.R.C. § 501(q)(2) (2018).

well-known and well-publicized,²⁸¹ I suspect that such use could attract Congressional attention as an abuse of current law and produce a new set of rules, as it did in the case of credit counseling organizations. That is, this use of section 501(c)(4) could prompt further restrictions, unlike the developments such as those in connection with veterans' organization or homeowners' associations that led to additional bases for exemption.

VIII. Possible Reform of Section 501(c)(4)

With all the recent concern about the role of section 501(c)(4) organizations in campaign intervention after *Citizens United*,²⁸² many recent proposals for reform have concentrated on that aspect of section 501(c)(4). For example, in 2013, the New York Times hosted a debate, "Does the IRS Scandal Prove That 501(c)(4)'s Should be Eliminated?"²⁸³ Professor John Colombo argued that they should; Professor Lloyd Mayer argued for disclosure of donors regardless of tax classification and for regulation by the FEC instead of the IRS; I suggested a new category for organizations primarily engaged in lobbying.²⁸⁴ Rosemary Fei and Douglas Mancino reminded readers that section 501(c)(4) also covered such important activities as low income housing and health maintenance organizations.²⁸⁵

In a piece drafted before the Tea Party controversy and included in this symposium issue, Professor Daniel Halperin outlined an approach to taxation of section 501(c)(4) organizations based not on their potential for political activity, but the benefits they offer their members.²⁸⁶ In particular, he argues for taxation of the investment income of section 501(c)(4) organizations that offer members more than incidental benefits.²⁸⁷ He contends that section

²⁸¹ Such use of section 501(c)(4) may be an unintended consequence of the 2016 legislative change making clear that transfer to section 501(c)(4) organizations are not subject to gift tax. *See supra* note 54.

²⁸² *See generally* Center for Responsive Politics, *supra* note 4.

²⁸³ The Opinion Pages, *Room for Debate*, *Does the I.R.S. Scandal Prove that 501(c)(4)'s Should Be Eliminated?*, N.Y. TIMES, May 15, 2013, available at <https://www.nytimes.com/roomfordebate/2013/05/15/does-the-irs-scandal-prove-that-501c4s-should-be-eliminated/the-irs-should-eliminate-501c4-organizations>.

²⁸⁴ Rosemary Fei and Eric Gorovitz make a somewhat similar but much more sophisticated suggestion in their paper for this symposium. [cite to be added]

²⁸⁵ The Opinion Pages, *Room for Debate*, *supra* note 283.

²⁸⁶ Halperin, *Section 501(c)(4)*, *supra* note 31.

²⁸⁷ *Id.* David S. Miller has also suggested taxing the investment income of section 501(c)(4) organizations, but on a very different basis: that any 501(c)(4) and other tax-exempt organization that engages in "any substantial amount of lobbying or campaigning would be taxable on all of its net investment income." David S. Miller, *Reforming the Taxation of Exempt Organizations and Their Patrons*, 67 TAX. LAW. 451, 492 (2014). [*supra* note 87]

501(c)(4) organizations that provide more than incidental benefits to members should be seen as another category of mutual organizations and taxed like social clubs.²⁸⁸

In 1969, Congress explained the principles behind taxation of social clubs as under a theory of pooling:

Since the tax exemption for social clubs and other groups is designed to allow individuals to join together to provide recreational or social facilities or other benefits on a mutual basis, without tax consequences, the tax exemption operates properly only when the sources of income of the organization are limited to receipts from membership. Under such circumstances, the individual is in substantially the same position as if he had spent his income in pleasure or recreation (or other benefits) without the intervening separate organization.²⁸⁹

But this pooling principle for exemption does not extend to exemption for nonmember income, including investment income, and social clubs are taxed on these amounts.²⁹⁰

Halperin's work on section 501(c)(4) builds on his earlier work regarding section 501(c)(5) and 501(c)(6) organizations and the extent to which various types of income of tax-exempt organizations should be taxed.²⁹¹ This work, in turn, built on the work of Bittker and Rahdert and Hansmann.²⁹² In their classic article, *The Exemption of Nonprofit Organizations from Federal Income Tax*, Bittker and Rahdert classified political organizations and section 501(c)(4) organizations along with section 501(c)(3) as public service organizations that should be exempt from income tax because there is no satisfactory way either to define and compute their income or to fit the tax rate to the ability of their beneficiaries to pay.²⁹³ Bittker and Rahdert viewed unions and business leagues along with social clubs and consumers' cooperatives as mutual benefit organizations operated to provide goods and services to their members

²⁸⁸ Halperin, *Section 501(c)(4)*, *supra* note 31.

²⁸⁹ S. Rep. No. 91-552, 91st Cong, 1st Sess. 71 (1969).

²⁹⁰ See I.R.C. § 512(a)(3) (2018).

²⁹¹ Daniel Halperin, *Income Taxation of Mutual Nonprofits*, 59 TAX L. REV. 133 (2006).

²⁹² The next three paragraphs are taken from Aprill, *supra* note 51.

²⁹³ Boris L. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Tax*, 85 YALE L. J. 299 (1976).

at cost.²⁹⁴ Exempting the accumulated income of a business league or union was “the equivalent of currently imputing its income to its members, but allowing them to deduct these amounts when they are ultimately used,” or allowing the organization to reduce dues in future years, thus compensating “the Treasury, albeit belated, for the revenue lost by exempting the . . . income when realized . . . except for the time value of money.”²⁹⁵ The authors did not seem especially concerned with the time value of money lost to the Treasury.

Henry Hansmann famously disputed Bittker and Rahdert’s contention that we cannot construct a workable definition of income for nonprofits.²⁹⁶ Even for section 501(c)(3) nonprofits that depend on donations, such as the Red Cross, he urged conceptualizing the donor as buying the product or service the organization provides.²⁹⁷ In the case of the Red Cross, for example, the services provided would be disaster relief.²⁹⁸ Without exemption, tax would apply to earnings saved for expenditures in future years and net capital investment, which Hansmann called retained earnings.²⁹⁹ Exemption thus operates as a subsidy for capital that nonprofit exempt organizations cannot raise from private investors.³⁰⁰ Under Hansmann’s analysis, then, it would seem that exemption of tax on retained earnings of section 501(c)(4) organizations would also be seen as a tax subsidy. Hansmann criticized the exemption for social clubs because the members themselves could provide capital,³⁰¹ but did not discuss 501(c)(4), (5) or (6) organizations as such.

Daniel Halperin has extended Hansmann’s work regarding taxation of capital to section 501(c)(5) and section 501(c)(6) organizations.³⁰² He views the goal in taxing such entities to be the proper measure of income rather than the provision of any special subsidy.³⁰³ He largely

²⁹⁴ Bittker & Rahdert, *supra* note 293, at 348.

²⁹⁵ Bittker & Rahdert, *supra* note 293, at 354-55. At the time the authors were writing, union dues were likely to be deductible, since the limits on deduction of unreimbursed employee expenses under § 67 were not introduced until 1986.

²⁹⁶ Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L. J. 54, 56-62 (1981).

²⁹⁷ Hansmann, *supra* note 296, at 59-60.

²⁹⁸ Hansmann, *supra* note 296, at 61.

²⁹⁹ Hansmann, *supra* note 296, at 59-60.

³⁰⁰ Hansmann, *supra* note 296, at 62-63.

³⁰¹ Hansmann, *supra* note 296, at 94.

³⁰² Halperin, *supra* note 291. Unlike Bittker and Rahdert, he categorizes political organizations as mutual nonprofits.

³⁰³ Halperin, *supra* note 31, at [WILL NEED TO USE PAGE IN THIS VOLUME]

accepts Bittker and Rahdert's analysis, but, unlike them, assigns great significance to the time value of money. "Since member dues, and for that matter investment and other income, might not be used for business expenses until a future taxable period, then failure to tax such income when received results in tax deferral for the association."³⁰⁴ He reviews a number of mechanisms to end the deferral: permitting deductions only when expenditures were incurred; allocating excess of current income over deductions back to members; and a 2000 Treasury proposal to tax the investment income of section 501(c)(6) organizations.³⁰⁵ He concludes that taxation of investment income is less accurate but simpler to administer than other alternatives, dubbing it "an indirect way of eliminating the benefit of deferral."³⁰⁶ In effect, the current exemption from taxation for investment income operates as a deferral that amounts to a subsidy, with the longer the deferral, the larger the tax benefit.

Professor Halperin extends his analysis regarding the tax subsidy of deferral—and thus a recommendation that investment income be taxed—to those section 501(c)(4) organizations that provide more than incidental benefits to those who belong to the organization.³⁰⁷ Currently, as Professor Halperin makes clear, section 501(c)(4) organizations with investments receive an income tax subsidy that section 501(c)(4) without investment income do not.³⁰⁸ Since contributions to section 501(c)(4) organizations are not deductible as charitable contributions, many section 501(c)(4) organizations do not have investment income to exempt. They thus receive little if any federal tax benefit from income tax exemption. As Halperin explains:

the charitable deduction reduces the cost of both current and future charitable outputs. An income tax exemption, on the other hand, will not, for the most part reduce the costs of current operations. It will affect only the relative costs of setting aside funds for the future compared with providing current benefits. As such, unlike the charitable deduction it will subsidize **only** those organizations that accumulate funds while denying **any** benefits to those which spend relatively quickly.³⁰⁹

³⁰⁴ Halperin, *supra* note 291, at 155.

³⁰⁵ Halperin, *supra* note 31, at [page in symposium volume].

³⁰⁶ Halperin, *supra* note 31, at [page in symposium volume].

³⁰⁷ Halperin, *supra* note 31, at [page in symposium volume].

³⁰⁸ Halperin, *supra* note 31, at [page in symposium volume].

³⁰⁹ Halperin, *supra* note 31, at [page in symposium volume].

Professor Halperin makes clear the great value that tax-free buildup of investment income bestows. Nominally, all section 501(c)(4) organizations are subject to the same tax regime, but in practice they are not; only those with investment income benefit from income tax exemption.³¹⁰

Professor Halperin's basic approach regarding taxation of investment income persuades me. The proposal, however, faces challenges. Applying the distinction he endorses would be as problematic as the current application of the private benefit doctrine to various subsections of section 501(c).

Experience under section 501(c)(3) demonstrates the difficulties in applying the concept of incidental private benefit. As noted earlier, an organization will not qualify for exemption under section 501(c)(3) unless "it serves a public rather than a private interest."³¹¹ The IRS allows organizations to qualify under section 501(c)(3) if they provide no more than "incidental private benefit."³¹² The IRS has stated that private benefit must be incidental both qualitatively and quantitatively.³¹³ Such guidance gives little help as to where incidental stops and impermissible begins. Hopkins laments, "The private benefit doctrine is boundless; its use by the IRS is pliant."³¹⁴

State law treatment of nonprofit organizations will not be helpful in identifying those section 501(c)(4) organizations that provide their members with more than incidental private benefit. Under some state laws that distinguish public benefit from mutual benefit organizations, most if not all section 501(c)(4) organizations, like section 501(c)(3) organizations, would

³¹⁰ Other of Professor Halperin's work addresses the impact on section 501(c)(3) organizations of the exemption for investment income. See Daniel Halperin, *Is Income Tax Exemption for Charities a Subsidy?*, 64 TAX L. REV. 283 (2011); Daniel Halperin, *Tax Policy and Endowments: Is Excessive Accumulation Subsidized?*, 67 EXEMPT ORG. TAX REV. 125 (2011).

³¹¹ Treas. Reg. § 1.501(c)(3)-1(d)(3)

³¹² Andrew Megosh et al., *Topic H, Private Benefit Under IRC 501(c)(3)*, CPE Text for Fiscal 2000, available at <https://www.irs.gov/pub/irs-tege/eotopich01.pdf> (citing GCM 37789). See also Andrew Megosh et al, *Overview of Private Inurement/Private Benefit Issues in IRC 501(c)(3)*, 1990 CPE Text, available at <https://www.irs.gov/pub/irs-tege/eotopic90.pdf>.

³¹³ Andrew Megosh et al., *Topic H, Private Benefit Under IRC 501(c)(3)*, CPE Text for Fiscal 2000, available at <https://www.irs.gov/pub/irs-tege/eotopich01.pdf> (citing GCM 37789). See also Andrew Megosh et al, *Overview of Private Inurement/Private Benefit Issues in IRC 501(c)(3)*, 1990 CPE Text, available at

³¹⁴ Hopkins, *supra* note 6, at 607. See also John Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063 (2006).

seem to qualify as public benefit corporations.³¹⁵ The webpage of the California Secretary of State, for example, directs that “a corporation organized to act as a civic league or social welfare organization and which plans to obtain . . . federal tax exempt status under Internal Revenue Code section 501(c)(4) is a nonprofit Public Benefit corporation.”³¹⁶ The April 2016 Draft American Law Institute, Restatement of the Law: Charitable Nonprofit Organizations comments that “[s]ome, but not all,” organizations exempt under section 501(c)(4) “may be considered charities for state-law purposes.”³¹⁷ The draft Restatement, however, does not specify how to distinguish those that do from those that do not, as Professor Halperin’s approach would require.

Requiring that members be a member with legal rights under state law, whether in the context of a public benefit or mutual benefit organization, would be a bright line rule easy to apply. I do not think, however, that being such a member captures the kind of “more than incidental” benefit that Halperin has identified.³¹⁸

Moreover, the IRS, however, believes that state law prevents it from revoking the exemption even of a section 501(c)(4) organization that are mutual benefit organizations with legal members who have the right to receive assets upon the organization’s dissolution, rights that would seem to indicate clearly impermissible private benefit. According the 1981 CPE Text, the IRS has made the argument for revocation of section 501(c)(4) status for such organizations based “on the concept that an irrevocable dedication of assets to public purposes as much an essential element of social welfare in 501(c)(4) as it is for charitable property in 501(c)(3).”³¹⁹

³¹⁵ Fishman, Schwarz, Mayer, *supra* note 104, at 51, explain, “A public benefit organization can be defined as a group . . . to do good works, benefit society or improve the human condition. In contrast, a distinctive characteristic of mutual benefit organizations is that they are formed primarily to further the common goals of their members rather than for profit or a public or religious purpose.”

³¹⁶ California Secretary of State, Corporate Filing Tips, *available at* <http://www.sos.ca.gov/business-programs/business-entities/filing-tips/filing-tips-corp/#artsnp>.

³¹⁷ American Law Institute, Restatement of the Law: Charitable Nonprofit Organizations, Tentative Draft No. 1 (April 13, 2016), § 1.01(8).

³¹⁸ See *supra* note 156.

³¹⁹ 1981 CPE Text, *supra* note 20.

However, “courts have for the most part rejected this argument because the dissolution of social welfare groups is largely dictated by state law relating to dissolution of membership organizations.”³²⁰

The current Form 990 also gives little help in any attempt, as Halperin’s approach would require, to distinguish section 501(c)(4) organizations with members who benefit from association with the exempt organization from those without such members. The instructions to Form 990 explain that “[m]embership dues can consist of both contributions and payments for goods and services. In that case, the portion of the membership dues that is payment for goods or services should be reported on line 2, *Program Service Revenue*. The portion that exceeds the FMV of the good or services provided should be reported on line 1b.”³²¹ The instructions continue with a heading, “Membership dues and assessments received that compare reasonably with membership benefits provided by the organization.”³²² It then explains, “Organizations described in section 501(c)(5), (6) or (7) generally provide benefits that have a reasonable relationship with dues.”³²³ No mention is made of section 501(c)(4).

I would suggest that, instead of revising section 501(c)(4) to tax the investment income of those organization that provide members with more than incidental benefit, we establish at least a brighter line and tax the investment income of any section 501(c)(4) with members who receive any benefits beyond the legal rights of members under state law to vote for directors and on major corporate changes. Moreover, I would not require that a member have such legal

³²⁰ 1981 CPE Text, *supra* note 20. The 1981 CPE Text states that “legislative action” would be necessary to change this rule. *Id.* I question this reasoning and conclusion. The case the 1981 CPE Text cites, *Mill Lane Club, Inc. v. Comm’r*, 23 T.C. 433 (1954), *acq.* C.B. 1955-1, 5, is in fact a case involving a social club, not a social welfare organization. Moreover, the 1981 CPE Text ignores the fact that regulations under section 501(c)(4), unlike those for section 501(c)(3), do not require that assets must be dedicated to one or more exempt purposes upon dissolution. Legislative action is not needed. Regulatory amendment would suffice.

³²¹ Instructions for 2017 Form 990, page 37, *available at* <https://www.irs.gov/pub/irs-pdf/i990.pdf>.

³²² Instructions for 2017 Form 990, page 38, *available at* <https://www.irs.gov/pub/irs-pdf/i990.pdf>.

³²³ Instructions for 2017 Form 990, page 38-39, *available at* <https://www.irs.gov/pub/irs-pdf/i990.pdf>. Examples listed include subscriptions to publications, newsletters, free or reduced-rate to events sponsored by the organization, use of the facilities, and discounts on articles or services that member and nonmembers can buy.” *Id.* The glossary to the Form 990 does not define “member.”

rights; those associated with the organization who pay some kind of “membership fee,” subscription, or its equivalent and, as a result, receive benefits from it (the contributor-beneficiary) would be members for this purpose.³²⁴

One possibility would be to define “more than incidental private benefit” by borrowing from prior election law. Long before *Citizens United* allowed all corporations to engage in campaign intervention, the Supreme Court held in *Massachusetts Citizens for Life v. FEC* that the constitution required certain nonprofit corporations, unlike other corporations at the time, to be able to use treasury funds to advocate expressly for candidates in a federal election.³²⁵ The nonprofit corporations permitted to engage in such campaign intervention had to be 1) formed for the express purpose of promoting political ideas and prohibited from engaging in business activities; 2) have no shareholders or others with a claim to its assets or earnings; and 3) not be established by a business corporation or labor union and not accept contributions from such entities.³²⁶

In its regulations implementing *Massachusetts Citizens for Life*, the FEC defined a qualified nonprofit corporation eligible for this special treatment as a section 501(c)(4) organization that met the three requirements of the case and also did not have any persons who received benefits such as “credit cards, insurance policies or savings plans” or “training, education, or business information.”³²⁷ I recommend that Congress or the IRS could use this FEC definition or a similar approach to defining which section 501(c)(4) organizations offer more than incidental private benefit and thus would be taxed on investment income in order to provide a bit more clarity and certainty as to what constitutes more than incidental private benefit.

For 2012, according to IRS Statistics of Income, investment income, including investment

³²⁴ This idea, if pursued, would need further development, both to avoid gaming and to draw the appropriate lines. For example, a definition would need to make clear whether campers who pay fees for camps would be considered members for this purpose. Also, a de minimis exception, like that used for quid-pro-quo contributions, see Rev. Proc. 90-126 and Rev. Proc. 92-49, would seem appropriate. Most importantly, an anti-abuse rule would be needed to prevent a series of related organizations that separate membership fees from membership benefits. I note that the 2017 Form 990 requires reporting of membership dues paid to other organizations “to obtain general membership benefits from other organizations, such as regular services, publications, and other materials.” Instructions for 2017 Form 990, page 45, available at <https://www.irs.gov/pub/irs-pdf/i990.pdf>.

³²⁵ 479 U.S. 238 (1986).

³²⁶ 479 U.S. at 264.

³²⁷ Former 11 CFR § 114.10, 60 FR 35292, 35305-6 (July 6, 1995). The regulation, because of its context, did allow training or education “necessary to enable recipients to engage in the promotion of the group’s political ideas.” *Id.*

income, royalties, rent, and net capital gain from sales of assets—all items of the type taxed as investment income for private foundations under section 4940—for all section 501(c)(4) that report at least one or more members totals about \$1.14 billion, a not insignificant number.³²⁸ Of course, any tax on investment income would encourage section 501(c)(4) organizations to change their portfolio choices to reduce the amount of income. But such is the case for any provision that taxes investment income, whether that applicable to social clubs under section 512(a)(3), private foundations under section 4940, or certain university endowments under new section 4968.³²⁹

I would urge other changes to the taxation of section 501(c)(4) organizations. In addition to organizations that provide benefits to members, section 501(c)(4) encompasses non-member organizations that receive contributions, particularly section 501(c)(4) organizations that engage primarily in grantmaking and those that engage in political activity, whether lobbying or campaign intervention.³³⁰ At least for these section 501(c)(4) organizations, if not for all organizations exempt under section 501(c)(4), I would also suggest taxing appreciation on contributed assets to the donor, as we do under section 84 for political organizations.³³¹ For those section 501(c)(4) organizations involved in campaign intervention, such tax on appreciation

³²⁸ Personal communicate from Professor Brian Galle, March 2, 2018, on file with author. Galle notes that IRS Statistics of Income data take based on samples, but do include all organizations with more than \$10 million in assets, and thus gives a good sense of investment income. Another set of sources is data from individual large section 501(c)(4) organizations. AARP's 2015 Form 990 reports investment income for the year as \$112,678,020. It also lists \$838,640,664 of royalty income. Blue Care Network of Michigan, which the NCCS lists as the second largest section 501(c)(4) by gross receipts, *see supra* note 130, reports investment income of \$35,437,699 and no income from royalties on its 2015 Form 990. *See* Blue Care Network of Michigan, 2015 Form 990, *available at* <http://www.guidestar.org/FinDocuments/2015/382/359/2015-382359234-0d8352ab-90.pdf>. The third largest, Delta Dental of California, reports investment income of \$23,843,241 and no royalties on its 2015 Form 990. *See* Delta Dental of California, 2015 Form 990, *available at* <http://www.guidestar.org/FinDocuments/2015/941/461/2015-941461312-0d6f6f61-90.pdf>.

³²⁹ *See* I.R.C. §§ 512(a)(3), 4940, and 4968 (2018).

³³⁰ *See supra* Part IV.

³³¹ *See* I.R.C. § 84 (2018). This provision requires a transferor contributing appreciated property to a political organizations to pay tax on the appreciation. Section 84 defines political organization by reference to section 527. A section 527 organization must be “organized and operated primarily” for the function of “influencing, or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors.” I.R.C. § 527(e)(1) and (2) (2018).

would remove one of the incentives for using a section 501(c)(4) instead of a section 527 organization.³³² For section 501(c)(4) organizations that engage primarily in grantmaking, such a tax would provide a kind of counterbalance to the ability of such organizations to avoid the private foundation excise taxes. Admittedly, most section 501(c)(4) organizations fall into neither of these categories. For these organizations, we need to consider whether recognition of gain upon contribution of appreciated assets to any section 501(c) organization is the proper approach as a matter of policy and whether section 501(c)(4) is an appropriate place to enact the policy.³³³

I would also tax section 501(c)(4) organizations that are not membership organizations (again, using member to mean someone who pays dues and receives benefits, whether or not the person has legal rights as a member) on the lesser of their investment income or the amount spent on lobbying, as we do for amounts spent by section 501(c) organizations on campaign intervention under section 527(f). Not taxing all amounts spent lobbying by noncharitable organizations undermines an important tax principle related to political activities. The Internal Revenue Code, with the important exception for the limited lobbying permitted for section 501(c)(3) organizations, requires that only after-tax amounts be spent on political activities, whether lobbying or campaign intervention. That is, funds so used must be taxed at least once.³³⁴ Thus, section 162(e) denies a business deduction for lobbying. Under section 6033(e),

³³² Unlike section 501(c)(4), however, section 527 organizations must publicly disclose the names of donors. The fact that section 501(c)(4) organizations are not required to disclose their donors publicly would remain a significant advantage for section 501(c)(4) organizations. For further comparison of section 501(c)(4) and section 527 organizations, see Aprill, *supra* note 51.

³³³ Much attention has been given to the ability to donate appreciated assets to charities without a tax on appreciation while nonetheless receiving a charitable contribution deduction for full fair market value. See, e.g., Roger Colinvaux, *Charitable Contributions of Property: A Broken System Reimagined*, 50 HARV. J. ON LEG. 687 (2013); Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L REV. 1 (2002). Donors to other section 501(c) organizations, although they cannot take a deduction, do have the ability to contribute appreciated property without deemed realization. Little attention has been paid to this benefit and the contrast to section 84. The first piece of scholarship to identify this issue was, I believe, Gregg D. Polsky and Guy-Uriel Charles, *Regulating 527 Organizations*, 73 G.W. L. REV. 1000 (2005); I discuss the issue in Aprill, *supra* note 45. David E. Miller responded to my recommendation regarding section 84 in *Reforming the Taxation of Exempt Organizations and Their Patrons*, 67 TAX LAW. 451 (2014). [*supra* note 87] He argues that the donation of appreciated property to a section 501(c) organization should be treated as a sale by the donor and be taxed. *Id.* at 461.

³³⁴ See *Disclosure of Political Activities of Tax-Exempt Organizations: Hearings Before the Subcomm. On Oversight of the H. Comm. on Ways and Means, 106th Cong. 2000* (statement of Joseph M. Mikrut, Tax Legislative Counsel, Dep't of the Treasury).

a tax-exempt organization that engages in lobbying funded by tax-deductible membership dues and other contributions must either pay a “proxy” tax on its lobbying activities or follow notification “flow-through provisions.”³³⁵ This complicated set of rules works to ensure that amounts spent on lobbying do not enjoy the subsidy of deduction. It does not, however, address amounts spent on lobbying, especially by section 501(c)(4) organizations without members, that have enjoyed the subsidy of untaxed investment income. To the extent that we require investment income of section 501(c)(4) organizations to be taxed in connection with amounts spent on campaign intervention so that all amounts used for political purposes be taxed at least once, we should do the same for amounts spent on lobbying, whether or not the organization receives dues deductible by its members.³³⁶

Further, we need also to consider carefully and explicitly whether there should be an exception from the estate tax for section 501(c)(4) organizations.³³⁷ In enacting an exception for transfers to section 501(c)(4) organization from the gift tax but not the estate tax,³³⁸ Congress reacted to a particular controversy and followed the model established for transfers to political organizations, which also enjoy exception under the gift tax but not the estate tax.³³⁹ My understanding from discussion with practitioners is that currently they must engage in careful and elaborate tax planning to avoid estate tax inclusion under section 2036(a) when a contributor to a section 501(c)(4) organization retains rights to designate the persons who can enjoy property or income from property, as, for example, as a director and/or officer of a section 501(c)(4)

³³⁵ I.R.C. 6033(e) (2018). The proxy tax is imposed at the highest marginal rate of the corporate income tax on all lobbying expenses of the tax-exempt organization, as defined in section 162(e)(1). *Id.* The flow-through option requires the organization to provide all donors or other contributors with a reasonable estimate of the portion of dues or other contributions that is allocable to expenditures not deductible under section 162. See Aprill, *supra* note 51, at 377-79.

³³⁶ See section 527(f) (2018). Such income is taxed at the highest rate of tax specified in section 11(b). § 527(b).

³³⁷ See discussion of whether current section § 2055 might apply to grantmaking section 501(c)(4) organizations in David Miller’s paper for this symposium.

³³⁸ As *supra* Part III describes, the recent legislation also provided an exception from the gift tax for section 501(c)(5) and (c)(6) organizations, and a full analysis of extending the estate tax would require consideration of these organizations as well.

³³⁹ See I.R.C. § 2501(a)(4) (2018). Legislative history of the provision applicable to political organizations states that “if a decedent includes a political organization as a beneficiary of his estate, the amount so transferred is to be included in his estate.” S. Rep. No. 93-1357 at 30. Eric G. Reiss, *Mr. Soros Goes to Washington: The Case for Reform of the Estate and Gift Tax Treatment of Political Contributions*, 41 REAL PROP., PROB. & TR. J. 299, 301 (2007), argues that transfers to political organizations should also be exempt from estate tax because “a bequest at death is less likely to have a corrupting influence on public officials than a gift made during lifetimes.”

organization.³⁴⁰ I have been told that this situation arises most often with section 501(c)(4) organizations engaged in political activity.³⁴¹ Well-advised contributors to section 501(c)(4) organizations thus can avoid an estate tax liability that less sophisticated donors cannot.³⁴²

On one hand, we may conclude that it is appropriate to maintain the new status quo, with a gift but not estate tax exception. The current scheme parallels that applicable to political organizations, and it seems, as discussed in Part III, that Congress had section 501(c)(4) organizations engaged in political activity in mind when it passed the gift tax provision.³⁴³ Subjecting grantmaking section 501(c)(4) organizations to estate tax inclusion may serve as a kind of substitute for application of the private foundation excise taxes. On the other hand, there are many other types of section 501(c)(4) organizations, as discussed in Part IV, and we may conclude that the relationship between the gift and estate tax as a supposedly unified system mandates extending the exception to the estate tax. Congress, however, did not make this change in the 2017 tax legislation; it instead doubled the exclusion amount for gift and estate from \$5 million to \$10 million, adjusted for inflation, through 2025.³⁴⁴

Taxing all or even some of the investment income of section 501(c)(4) organizations or making the other changes I have suggested would represent a fundamental change to section 501(c)(4). The suggested changes do not go so far as calling for repeal of the provision. The provision has a long history. Its catch-all nature serves an important function. The changes instead call for recognizing that at least some section 501(c)(4) organizations in at least some ways resemble section 501(c)(3) organizations less than they resemble other section 501(c) organizations and should be taxed accordingly.

³⁴⁰ Cf. Rev. Rul. 72-552. There, the value of property transferred to a foundation was includible in decedent's gross estate under § 2036(a)(2) because as a director and the president of foundation, decedent had power to direct disposition of fund by determining charitable recipients. Although the property was included in the gross estate, its inclusion was offset by the charitable deduction.

³⁴¹ Techniques described to me include having children and close associates of the transferor, but not the transferor him or herself, serve as directors and officers of the section 501(c)(4) organization or requiring all the assets of the section 501(c)(4) organization to be contributed to a section 501(c)(3) organization upon the death of the transferor.

³⁴² Of course, with the current estate tax exclusion set at over \$22,000,00 for a married couple, only the very wealthy are subject to estate tax. See Internal Revenue Service, *Estate Tax*, available at <https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax>.

³⁴³ See I.R.C. § 2501(a)(6) (2018).

³⁴⁴ Section 2010(c)(3)(C) (2018), as amended by the Tax Cuts and Jobs Act of 2017.

IX. The Future of Section 501(c)(4) Organizations

As discussed earlier, donations to section 501(c)(3) organizations are deductible as charitable contributions, but organizations exempt as charities under section 501(c)(3) can lobby only to a limited extent and are prohibited completely from engaging in campaign intervention. In contrast, donations to section 501(c)(4) organizations are not deductible as charitable contributions but such organizations can lobby without limit in connection with their exempt purpose and can engage in campaign intervention to a considerable extent.³⁴⁵ However, the 2017 Tax Cut and Jobs Act, by vastly reducing the number of taxpayers who can benefit from the charitable contribution deduction, could make section 501(c)(4) organizations comparatively much more attractive to contributors.

A charitable contribution deduction benefits only those taxpayers who choose to itemize their deductions rather than take the standard deduction. In recent years, approximately 30% of taxpayers have itemized their deductions.³⁴⁶ The 2017 tax legislation, however, made two changes, both effective through 2025, that will drastically reduce the number of taxpayers who itemize. First, it increased the standard deduction to \$24,000 for married couples and \$12,000 for single persons.³⁴⁷ Second, it limited the deduction for state and local taxes to \$10,000, both for married couples and single individuals.³⁴⁸

As a result of these changes, the percentage of taxpayers who will itemize is estimated to fall sharply; the vast majority of taxpayers—almost 90 percent—will benefit more from taking the standard deduction.³⁴⁹ Those taxpayers with income between \$100,000 and \$200,000 will show a particularly large shift from itemizing to taking the standard deduction, dropping from over 50% to under 20%.³⁵⁰

³⁴⁵ See *supra* Part I.

³⁴⁶ Sean Lowry, *Itemized Tax Deductions for Individuals: Data Analysis*, at 2 (Congressional Research Service September 21, 2017); Tax Policy Center, Model Estimates, T18-001 – Impact on the Number of Itemizers of H.R. 1, the Tax Cuts and Jobs Act (TCJA) by Expanded Cash Income Level, *available at* <http://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0001-impact-number>.

³⁴⁷ I.R.C. § 63 as amended by the sec. 11011(b)(2) of P.L. 115-97 (Tax Cuts and Job Act).

³⁴⁸ I.R.C. § 164 as amended by sec. 11042(a) of the Tax Cuts and Jobs Act.

³⁴⁹ Tax Policy Center, Model Estimates, T18-001 – Impact on the Number of Itemizers of H.R. 1, the Tax Cuts and Jobs Act (TCJA) by Expanded Cash Income Level, *available at* <http://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0001-impact-number>.

³⁵⁰ Howard Gleckman, *21 Million Taxpayers Will Stop Taking the Charitable Deduction under the JCJA*, TaxVox, Tax Policy Center (Jan. 8, 2018) *available at* <http://www.taxpolicycenter.org/taxvox/21-million-taxpayers-will-stop->

Many charitable organizations are worried about the impact of these changes on charitable giving.³⁵¹ The nonpartisan Tax Policy Center estimates that the number of taxpayers claiming an itemized deduction for charitable giving will fall from about 37 million to 16 million³⁵² and charitable contributions could decline from \$12.3 billion to \$19.7 billion per year.³⁵³

Fewer itemizers, however, could mean the growth of section 501(c)(4) organizations. Charitable organizations most dependent on the middle class, which include organizations that provide social services, are now likely to have few itemizers among their donors.³⁵⁴ In contrast, the arts and higher education tend to enjoy support from higher income taxpayers.³⁵⁵ A number of nonprofit law experts believe that many nonprofits focused on social services and other activities supported by the middle class may decide to form new section 501(c)(4) organizations or encourage contributions to an existing section 501(c)(4) organization.³⁵⁶ For donors not itemizing the deductions, there is no tax disadvantage to giving to a section 501(c)(4) organization in-

[taking-charitable-deduction-under-tcja](#); see Tax Policy Center, Model Estimates, T18-009, Impact of the Tax Benefit Charitable Deduction of H.R. 1, The Tax Cuts and Jobs Act, By Expanded Cash Income Level, *available at* <http://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0009-impact-tax>, and T18-0010, Impact on the Tax Benefit of Charitable Deduction of H.R. 1, The Tax Cuts and Jobs Act, By Expanded Cash Income Percentile, 2018, *available at* <http://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0010-impact-tax>

³⁵¹ See, e.g., David Rogers, *GOP tax law a one-two punch to charities- and American giving*, POLITICO (Jan. 13, 2018), *available at* <https://www.politico.com/story/2018/01/13/gop-tax-law-charities-giving-339039>; Brian McGueeney, *The GOP tax reform will devastate charitable giving*, LA TIMES (Dec. 27, 2017), *available at* <http://www.latimes.com/opinion/op-ed/la-oe-mcqueeney-charitable-giving-under-new-tax-law-20171227-story.html>.

³⁵² *Id.*

³⁵³ *Id.* See <http://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0009-impact-tax>

³⁵⁴ Arton Capital and Wealth-X, *CHANGING PHILANTHROPY: TREND SHIFTS IN ULTRA WEALTH GIVING 11-12* (2016) *available at* <https://www.wealthx.com/report/the-wealth-x-and-arton-capital-philanthropy-report-2016/>; Alex Daniels and Anu Narayanswamy, *The Income-Inequality Divide Hits Generosity*, CHRONICLE OF PHILANTHROPY (Oct. 5, 2014) *available at* <https://www.philanthropy.com/article/How-The-Chronicle-Compiled-Its/156223>; Kate Rogers, *Poor, Middle Class and Rich: Who Gives and Who Doesn't*, FoxBusiness (Jan. 20, 2016), *available at* <http://www.foxbusiness.com/features/poor-middle-class-and-rich-who-gives-and-who-doesnt>; Center on Philanthropy at Indiana University, *Household Charitable Giving by Income Groups, 2005, Prepared for Google* (2007), 7, 15-6 *available at* https://philanthropy.iupui.edu/files/research/giving_focused_on_meeting_needs_of_the_poor_july_2007.pdf.

³⁵⁵ *Id.*

³⁵⁶ See Gene Takagi, *A prediction for nonprofits in 2018: Rise of the 501(c)(4) organizations*, NEO Law Group Blog (Jan. 25, 2018), *available at* <http://www.nonprofitlawblog.com/a-prediction-for-nonprofits-in-2018-rise-of-the-501c4-organizations/>.

stead of a section 501(c)(3) entity. But there are advantages. Tax-exempt section 501(c)(4) organizations can not only do good, but they can also lobby legislatures freely on issues important to them and give considerable support to candidates for election who share their positions on key issues.

Thus, given the coming conflict in Congress over the size and scope of the social safety net, the ability to engage in lobbying or campaign intervention through a section 501(c)(4) social welfare organization will hold enormous, perhaps irresistible, appeal, as such organizations will undoubtedly explain to potential donors.

Recent empirical work by Brian Galle on giving to section 501(c)(4) organizations, however, suggests that reduced giving to section 501(c)(3) organizations may also reduce giving to section 501(c)(4) organizations as well.³⁵⁷ He finds that gifts to section 501(c)(4) organizations respond to changes in the net-tax price of giving to charity, with nearly the same degree of response to changes in net-price.³⁵⁸ He suggests that one reason for this matched response may be that donors do not understand the difference between the two sets of donee organizations.³⁵⁹ He also entertains the possibility of strategic fundraising, in particular that section 501(c)(4) organizations might fundraise more aggressively during periods when the value of donating to competing c(3) organizations is higher.”³⁶⁰

I predict a different impact on strategic fundraising going forward—that given the changed landscape for itemizing deductions, section 501(c)(4) organizations will increase fundraising because the value of donating to competing section 501(c)(3) organizations has decreased for many. That is, for many taxpayers, the net tax-benefit is the same for donations to either type of organizations—zero.

Many have criticized Congress, in its hurry to pass the tax legislation, for failing to consider fully the combined impact of changes to the law, in particular on charitable giving.³⁶¹ I doubt

³⁵⁷ Brian D. Galle, *The Dark Money Subsidy? Tax Policy and Donations to 501(c)(4) Organizations* (posted Nov. 27, 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3075508.

³⁵⁸ *Id.* at 4.

³⁵⁹ *Id.* He observe that donors may be erroneously deducting their gifts to c(4) organizations. *Id.* at 6.

³⁶⁰ *Id.* at 5.

³⁶¹ See, e.g., Jonathan Curry, *Rushed Timeline Blamed for Tax Law Marred by Glitches*, TAX NOTES (March 5, 2018) 1429-1430. [Add Law and Contemporary Problems symposium issue on past, present and future of the tax legislative process if citation available].

very much that anyone in Congress gave a moment's thought to the possibility that the legislation would, inadvertently, encourage the expansion of section 501(c)(4) organizations. Section 501(c)(4) organizations unlike political organizations subject to section 527, do not have to disclose their donors.³⁶² Thus, growth of section 501(c)(4) organizations will encourage the likely growth of unknown and unidentifiable donors free to engage in substantial electioneering. Moreover, if this shift occurs, activities traditionally undertaken by section 501(c)(3) organizations could move to section 501(c)(4) organizations, without the special protections, such as the limitations of charitable class and a narrower definition of private benefit that have regulated section 501(c)(3) organizations.³⁶³

X. Conclusion

Any changes to the taxation of section 501(c)(4) organizations, including taxation of investment income, seem unlikely despite Professor Halperin's valiant efforts to help us understand how exemption for investment income operates as an important subsidy for those tax-exempt organizations, including section 501(c)(4) organizations, able to accumulate funds.

Long-standing practice under section 501(c)(4), whether it is related to the amount of campaign intervention allowed,³⁶⁴ treatment of HMOs,³⁶⁵ or the degree of private benefit afforded to members,³⁶⁶ is resistant to change. While narrowly targeted legislation, such as that now applicable to credit counseling organizations³⁶⁷ and hospitals has its drawbacks, as Professor Colinvaux has discussed,³⁶⁸ codifying requirements for particular segments of section 501(c)(4) organizations, be they HMOs or community service clubs, may be a somewhat more

³⁶² See Aprill, *supra* note 51. See also Roger Colinvaux's paper for this symposium; Roger Colinvaux, *Political Activity Limits and Tax Exemption: A Gordian's Knot*, 34 VA. TAX REV. 1 (2014) [*supra* note 87] ; Lloyd Hitoshi Mayer, *Non-profit, Politics and Privacy*, 62 CASE-WESTERN L. REV. 801 (2012) [*supra* note 183].

³⁶³ See Ellen P. Aprill, *Charitable Class, Disaster Relief, and First Responders*, 153 TAX NOTES 949 (2016).

³⁶⁴ See text at *supra* notes 8-15.

³⁶⁵ See text at *supra* notes 202-223.

³⁶⁶ See *supra* Part VIII.

³⁶⁷ See text at *supra* notes 273-280.

³⁶⁸ Roger Colinvaux, *Charity in the 21st Century: Trending toward Decay*, 11 FLA. TAX REV 1, 48 (2011), finds statutory "micro-management" of credit counseling organizations and hospitals troubling and "unprecedented." Like Professor Mayer in his conference paper, I believe that section 501(c)(4) organizations that operate as grantmaking organizations free from the limits on private foundations are ripe for Congressional attention. [*supra* note 87]

likely legislative change as past history suggests. Congress has not been willing to consider wholesale changes to section 501(c)(3).

Even targeted changes seem to have little chance of enactment, absent some scandal. With hindsight, we might well wish that the statutory language of section 501(c)(4), the regulations applicable to it, and interpretations of it did not exist in their current form, particularly when it comes to campaign intervention. Nonetheless, it is likely that we will continue to live with the current version of section 501(c)(4) and all its uncertainties. Furthermore, the changes introduced by the 2017 tax legislation that will reduce the number of taxpayers who will itemized deduction may well fuel the growth of section 501(c)(4) organizations and thus magnify the impact of the provisions uncertainties in ways that will alter the tax-exempt sector, particularly by increasing grantmaking, lobbying, and campaign intervention under section 501(c)(4) instead of the more stringent rules regarding such activities for organizations exempt under section 501(c)(3).

Regardless of the likelihood for change, examination of this subsection reveals our uncertainty and ambivalence as to what activities merit tax exemption. It helps us to understand that federal tax exemption is not monolithic but involves a number of discrete elements—deductibility, deemed realization upon contribution of appreciated assets, treatment of investment income, applicable rates on income that is subject to income tax, applicability of the gift and estate tax as well as state issues including property and sales tax.

We need not offer every tax benefit to every category of section 501(c) organizations; we can mix and match according to the contribution that policymakers deem each category to make to civil society. For section 501(c)(4) organizations that offer benefits to members, additional tax in the form of taxing investment income is an option worthy of consideration. Such a tax could also discourage a movement by donors from section 501(c)(3) organizations to section 501(c)(4) organizations in order to help ensure that charitable activities are conducted by organizations subject to the law—statutory, regulatory, and judicial—that has developed in connection with tax-exempt charities. Doing so would further protect the boundaries that distinguish section 501(c)(4) from section 501(c)(3).

Appendix

Tables from Jeremy Koulish, Research Report: From Camps to Campaign Funds: The History, Anatomy, and Activities of Section 501(c)(4) Organizations, Urban Institute I (Jan. 2016)

501(c)(4) Organizations by Type

Organization type	Number and percentage of 501(c)(4) organizations registered	Number and percentage of 501(c)(4) organizations filing Form 990	Revenue (number and percentage)
Community service clubs	31,811(39.0%)	7,506(26.0%)	\$702,095,840(0.8%)
Health providers and insurers	459(0.6%)	314(1.1%)	\$62,715,346,590(72.5%)
Homeowner and tenant associations	1,891(2.3%)	988(3.4%)	\$586,706,079(0.7%)
Housing communities and developments	978(1.2%)	819(2.8%)	\$921,778,251(1.1%)
Military and veterans organizations	6,365(7.8%)	1,102(3.8%)	\$303,046,379(0.4%)
Neighborhood and community associations	3,804(4.7%)	1,557(5.4%)	\$870,579,428(1%)
Sports and recreation	8,265(10.1%)	3,888(13.5%)	\$3,413,831,029(3.9%)
Volunteer public safety	5,167(6.3%)	3,902(13.5%)	\$917,955,288(1.1%)
Other	22,750(27.9%)	8,790(30.4%)	\$10,780,905,841(12.5%)
Domestic total	81,490 (99.9%)	28,866 (99.9%)	\$81,212,244,725 (93.8%)
Foreign organizations	99(0.1%)	40(0.1%)	\$5,325,229,383(6.2%)
Total	81,589 (100%)	28,906 (100%)	\$86,537,474,108(100%)

Sources: IRS Business Master File, June 2014; NCCS Core File, 2012.

Note. See table 7 of this report for a breakdown of the "other" category.

501(c)(4) Organizations Filing Form 990, by Size

Revenue category	Number and percentage of 501(c)(4) organizations filing Form 990	Revenue (number and percentage)	Average revenue
\$0 or less	546(1.9%)	-\$14,472,097(-0.0%)	-\$26,506
\$1-\$25,000	5,146(17.8%)	\$62,128,219(0.1%)	\$12,073
\$25,001-\$50,000	5,608(19.4%)	\$207,196,635(0.2%)	\$36,947
\$50,001-\$100,000	6,577(22.8%)	\$466,959,472(0.5%)	\$70,999
\$100,001-\$500,000	7,856(27.2%)	\$1,678,495,252(1.9%)	\$213,658
\$500,001-\$1,000,000	1,394(4.8%)	\$976,637,708(1.1%)	\$700,601
\$1,000,001-\$5,000,000	1,281 (4.4%)	\$2,687,998,146(3.1%)	\$2,098,359
\$5,000,001-\$10,000,000	200(0.7%)	\$1,380,789,027(1.6%)	\$6,903,945
\$10,000,001-\$100,000,000	205(0.7%)	\$6,128,309,072(7.1%)	\$29,894,191
\$100,000,001-\$1,000,000,000	68(0.2%)	\$24,837,167,178(28.7%)	\$365,252,459
More than \$1,000,000,000	25(0.1%)	\$48,126,265,496(55.7%)	\$1,925,050,620
Total	28,906 (100%)	\$86,537,474,108 (100%)	\$2,993,755

Source: NCCS Core File, 2012.