The ABCs of 501(c)(4)s

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INTRODUCTION[1]

Nonprofit organizations form a critical part of the civic landscape of the United States. These organizations meet their missions in a variety of ways. Many of these organizations are well-served by maintaining tax exemption under Internal Revenue Code ("IRC") section 501(c)(3), pursuant to which donors can give tax-deductible charitable contributions, and the charitable organizations can conduct a variety of direct service, advocacy, and civic engagement activities. However, some organizations find the restrictions that come with IRC section 501(c)(3) status to be too stringent to be able to accomplish all of the change they wish to see in the world. In these circumstances, creating an affiliated organization that is exempt under IRC section 501(c)(4) can expand the tools available to a nonprofit organization to accomplish its mission. This guide reviews the reasons a 501(c)(3) charity might want to create a sister 501(c)(4) organization, describes the process of establishing that new entity, highlights some of the key legal considerations in operating a related 501(c)(4), and examines the circumstances under which the 501(c)(4) might want to establish a related 527 organization.

ADVANTAGES AND LIMITATIONS OF 501(c)(3) ORGANIZATIONS

There are benefits and challenges to conducting work through a 501(c)(3) nonprofit. Organizations that are tax-exempt under Section 501(c)(3) of the IRC can accept charitable contributions that are tax-deductible to the donor. This makes these organizations attractive places for donors to contribute funds. However, organizations exempt under 501(c)(3) also face relatively tight restrictions on the work they are permitted to conduct. This article will primarily discuss 501(c)(3)s that are classified as "public charities" through receiving income via a diversified funding stream; however, the reader should know that there are also 501(c)(3)s that are classified as private foundations, which face even tighter restrictions, including an absolute prohibition on engaging in lobbying activities.

Public charities are able to engage in some types of advocacy work, subject to limitations on the amount of lobbying they can conduct. They are prohibited from engaging in campaigns for public office, though they are allowed to participate in non-partisan voter education and civic engagement activities under limited circumstances. These restrictions are detailed below.

Lobbying Restrictions on 501(c)(3) Public Charities

Public charities must be organized for one or more tax-exempt purposes specified in section 501(c)(3), including charitable, religious, and educational purposes. They may not spend any substantial part of their activity engaged in propaganda or otherwise attempting to influence legislation – work that we often refer to as lobbying. However, this means that they may dedicate an *insubstantial* part of their activity to such efforts. In practice, there are two methods that public

[1] The authors are grateful to assistance from Kimberly Eney of Latham & Watkins LLP who provided valuable insight and edits and was a driving force in bringing this project to fruition.

charities can use to determine the amount of lobbying that they can conduct.

501(h) Expenditure Test

Most public charities have the ability to elect to measure lobbying under the test set out in IRC section 501(h)[2]. The 501(h) test is advantageous because it provides clear, dollar-based limits on the amount of lobbying a charity may conduct. The Treasury Regulations accompanying IRC section 501(h) also spell out clear definitions and useful exceptions for characterizing activities as lobbying or not. Further, if the organization exceeds the allowable amount of lobbying, it is subject to an excise tax of 25% of the excess lobbying expenditures, but will only lose its tax-exempt status if it spends more than 150% of the applicable lobbying limit over a 4-year average period.

The 501(h) calculation is based on a percentage of lobbying spending out of all "exempt purpose expenditures." Exempt purpose expenditures are those costs that further the nonprofit's mission. Operational expenses are included in this figure, but costs of an outside fundraiser are not. A charity making the 501(h) election may spend the following amounts in a fiscal year. The total allowable lobbying is capped at one million dollars per year; an organization would hit that cap with a budget of $17 million.

In addition to this overall lobbying cap, a separate limit is imposed on grassroots lobbying. Whatever the overall limit is, the grassroots lobbying nontaxable amount is 25% of that number. While direct lobbying is defined as direct communication with a public official that advocates a viewpoint on specific legislation, grassroots lobbying is a communication with the public and also requires a specific "call to action," such as asking members of the public to call their Member of Congress to ask them to support a particular bill.

Please see chart on the following page.

[2] A church or a convention or association of churches, or the integrated auxiliary of a church, or a member of an affiliated group if any group member is such a church organization, are not permitted to elect 501(h). (501(h)(5))

Lobbying Expenditures Allowed by a 501(c)(3) electing 501(h)

If the exempt purpose expenditures are—	The "lobbying nontaxable amount" is—
Not over \$500,000	20 percent of the exempt purpose expenditures.
Over \$500,000 but not over \$1,000,000	\$100,000, plus 15 percent of the excess of the exempt purpose expenditures over \$500,000.
Over \$1,000,000 but not over \$1,500,000	\$175,000 plus 10 percent of the excess of the exempt purpose expenditures over \$1,000,000.
Over \$1,500,000	\$225,000 plus 5 percent of the excess of the exempt purpose expenditures over \$1,500,000.[3]

[3] 29 U.S.C. § 4911

"No Substantial Part" Test

Charities that do not (or are not eligible to) elect to operate under 501(h) instead operate under the "no substantial part" test, which relies on the imprecise statutory language declaring that no substantial part of a public charity's activities may consist of propaganda or attempts to influence legislation. To rely on the no substantial part test is to operate in a legal grey area because the statute does not include detail either on the definition of lobbying, or on the exact percentage of an organization's activity that will be considered "substantial." Instead, the Internal Revenue Service will look at all of the facts and circumstances surrounding the organization's activity. Though there is no clear threshold for the resources that can be dedicated to lobbying under the no substantial part test, case law and IRS guidance suggest that up to 5% of total expenditures is probably safely insubstantial.[4] For large charities, measuring lobbying through the no substantial part test may provide a higher limit for lobbying activity, because while there is a cap of $1,000,000 using the 501(h) test, the no substantial part test has no definite cap. It may also allow more lobbying for an organization that does only grassroots lobbying because of the lower limit imposed on that activity under the expenditure test. However, due to the lack of clear definitions and specifically the regulations under the 501(h) test that add a "call to action" as an element of grassroots lobbying, it is likely that more grassroots communications would be captured as lobbying under the no substantial part test than under the 501(h) expenditure test.

The no substantial part test comes with higher risks. Lobbying efforts deemed to be "substantial" in any single year could lead to a revocation of tax-exempt status. The no substantial part test also does not include the same clear definition of lobbying contained in the 501(h) test. Because the definitions are less clear, it is safer to rely on a broad definition of lobbying and to assume that all communication with lawmakers or to the public that expresses an opinion on specific legislation should be counted toward lobbying.

Prohibition on Political Intervention

Public charities are strictly prohibited from intervening in campaigns for public office. This means they cannot endorse candidates, donate money or resources (including staff time) to political candidates, and may be limited in the work they can do with organizations that engage in political work. In order to determine whether a particular activity qualifies as electoral intervention, the IRS will look at all surrounding facts and circumstances. Activities that are deemed to signal support (explicitly or implicitly) for particular candidates or political parties will likely be considered campaign intervention, and thus be impermissible for a 501(c)(3) organization to conduct. This "facts and circumstances" test is imprecise by design, allowing the IRS to make determinations based on the totality of the information available. A 501(c)(3) may establish a 501(c)(4) that would have greater flexibility to engage in political activity, but a 501(c)(3) may not directly establish a PAC or other 527

[44] *See Seasongood v. C.I.R.*, 227 F.2d 907 (6th Cir. 1955) (finding that 5% of an organization's "time and effort" was insubstantial); *Haswell v. U.S.*, 500 F. 2d. 1133 (Cl. Ct. 1974) (finding that 16.6% of expenditures was substantial).

organization to engage in activities that the 501(c)(3) is prohibited from doing.[5]

This does not necessarily mean that 501(c)(3)s must avoid elections entirely. There are some activities that they are allowed to conduct, such as non-partisan voter education that does not express or suggest an opinion about the candidates. A 501(c)(3) may also conduct non-partisan voter engagement efforts (such as voter registration and get-out-the-vote) as long as those efforts are not calculated to aid one particular candidate or party.

What can 501(c)(4)s do that 501(c)(3)s cannot?

Nonprofit organizations exempt under IRC section 501(c)(4) have far fewer restrictions on their activities. There are also some trade-offs that come with 501(c)(4) status. Donations to 501(c)(4)s are not tax deductible as charitable contributions, and 501(c)(4)s are required to notify their donors that their donations are not tax-deductible as charitable contributions at the time the donation is made.[6] Because donations are not tax-deductible on this basis, it can be harder for these nonprofits to raise funds.

501(c)(4)s must be organized for the primary purpose of promoting social welfare.[7] They are permitted to engage in unlimited lobbying, and indeed lobbying may be the only activity that they conduct as long as it is related to their social welfare purpose. In general, any activity permissible for a 501(c)(3) organization will be considered to further social welfare if carried out by a 501(c)(4).

Depending on the way a 501(c)(4) conducts its lobbying work, there may be additional registration and reporting requirements under the federal Lobbying Disclosure Act or relevant state or local statutes. Each state has unique rules about the conduct that qualifies as lobbying and the requirements to register or disclose expenditures and sometimes sources of funding. Organizations engaging in state lobbying work should consult knowledgeable counsel about the requirements; state laws often have very broad definitions of lobbying that capture grassroots activities as well as direct communications with policymakers. Information about the federal LDA can be found at the U.S. Senate website.

Work on ballot measures is generally considered direct lobbying work for federal tax purposes, because campaigners interact

[5] There is a very narrow exception based on the fact that IRC § 527 covers attempts to influence nominations and appointments to office, while 501(c)(3)-prohibited campaign intervention is limited to influencing elections. *See* Notice 88-76, 1988-2 C.B. 392.

[6] Tax-exempt organizations other than those described by IRC 170(c) – generally charities, veterans organizations, and cemetery companies – must include in their fundraising solicitations an express statement that contributions or gifts to such organization are not deductible as charitable contributions for Federal income tax purposes. *See* Notice 88-120, 1988-2 C.B. 454.

[7] 26 CFR § 1.501(c)(4)-1(a)(2) states that an organization operating under Section 501(c)(4) is "operated primarily for the purpose of bringing about civic betterments and social improvements". The regulation goes on to state that "The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office." Unlike Section 501(c)(3) organizations, 501(c)(4)s are not unilaterally prohibited from engaging in such activity, but it cannot be the primary activity in which they are engaged.

directly with the decision-makers (in this case, the voters) on specific legislation. 501(c)(4)s are a useful structure for ballot measure committees because they can engage in unlimited lobbying. 501(c)(3)s may also engage in ballot measure work, but only up to their lobbying thresholds. States may impose additional regulations on ballot measure activity, including registration and reporting requirements on organizations that engage in work on ballot measures. Please research state law for your jurisdiction well before beginning any ballot measure activity, or consult with an attorney familiar with the laws in your state. Even starting to raise funds for this work may have implications for compliance down the road, so it is important to investigate the relevant law early on.

501(c)(4)s may also engage in a limited amount of political campaigning. Their "primary purpose" must be social welfare, which is generally interpreted to mean that a majority of the organization's activities must consist of social welfare activities related to their exempt purpose. Federal tax law allows a 501(c)(4) to endorse candidates, distribute voter guides that support or oppose candidates, permit candidates to address its members, rent its mailing lists, provide facilities to candidates, and establish and pay for the administrative and fundraising costs of a connected political organization. Note that this activity is also regulated by federal or state campaign finance law – check local law for your jurisdiction or consult with an attorney with expertise in this area. Additionally, a 501(c)(4) will be subject to tax on the smaller of its net investment income or its political activity.[8] While 501(c)(4)s may engage in political activity, they may not be organized primarily to benefit a political party.

CREATING A 501(c)(4)

The 501(c)(4) must operate as a separate entity. It must have its own board of directors (there can be partial or complete overlap between the 501(c)(3) and 501(c)(4) boards, which we will discuss below, but at minimum the boards must have distinct meetings where they govern the respective organizations), must pay its own expenses, and must file its own tax returns.

The steps for an existing 501(c)(3) nonprofit organization to establish a new 501(c)(4) are relatively quick and simple:

- Establish a legal entity
- Appoint officers
- Get an EIN
- File Form 8976 informing the IRS that the new entity intends to operate as a 501(c)(4)
- (Optional) File Form 1024(A) for official IRS recognition as a 501(c)(4)

First, the new organization must be established as a separate legal entity from the existing 501(c)(3). It may be established by the 501(c)(3) organization itself, by staff or directors of the 501(c)(3), or independently. Establishing the new legal entity will typically require filing articles of incorporation with the relevant state office, although a 501(c)(4) can also be organized as a trust. While the IRS does not require any "magic language" in the articles as is required to comply with the organizational test of Section 501(c)(3), depending on the state, additional provisions may be advisable to provide liability

[8] 26 U.S. Code §527(f)

protection to directors or otherwise reflect state nonprofit corporation law.

Once the new organization is incorporated (or established as a trust), it must take basic steps to begin operations: appoint the initial board (if not named in the articles of incorporation), appoint officers, adopt bylaws, and empower someone to obtain an EIN on behalf of the organization. The new organization should then establish its own, separate bank account using the new EIN.

Within 60 days of incorporating the new entity, the organization must file IRS Form 8976, the Notice of Intent to Operate Under Section 501(c)(4). Form 8976 must be filed online; the $50 fee to process the form must also be submitted online. The form may be completed by anyone that the board has authorized to act on behalf of the organization. Details about the filing process can be found on the IRS web site in the "Charities and Nonprofits" section, under "Apply for Tax-Exempt Status."

501(c)(4)s are not required to get an IRS determination of their exempt status in order to qualify for exemption as a 501(c)(4), but some organizations find it useful to have an IRS determination letter for donors or state tax exemption. It may also be beneficial to have a formal ruling of status on which the organization can rely in case the IRS later decides to question its qualification. If the entity has been operating consistently with what was represented in the application submitted to the IRS, its exemption cannot be revoked retroactively.

To apply for IRS recognition as a 501(c)(4), the organization may submit IRS Form 1024A, along with Form 8718 to submit their user fee. For the exemption to be recognized retroactive to the date of incorporation, the application must be submitted by the end of the 27th full month after the date of incorporation. If the organization submits a Form 1024A after the 27-month deadline has lapsed, the IRS will issue the ruling effective the date of the filing. The organization will not have a ruling on status for the earlier period, but that does not mean it does not qualify as exempt; the IRS simply will not have ruled on the question.

501(c)(4)s complete annual tax returns on Form 990 and may also need to complete several schedules in addition to their 990. They may need to submit Form 1120-POL and any FEC or state campaign finance reports for certain political expenses. Like any other incorporated entity, a 501(c)(4) structured as a nonprofit corporation will need to file annual reports according to the jurisdiction of incorporation.

MANAGING A 501(c)(4)

Establishing a 501(c)(4) can be a useful outlet for activities that a 501(c)(3) cannot do on its own, but the 501(c)(3) cannot subsidize the costs of the 501(c)(4)'s operations. For that reason, the two organizations need to take care to operate independently and manage their own costs.

Governance

The 501(c)(4) must have its own board, which conducts meetings, makes decisions, and ultimately controls the finances of the 501(c)(4). It is possible for there to be overlap between the boards of the 501(c)(3) and the 501(c)(4); however substantial overlap between the boards may pose some risks. If the 501(c)(4) conducts only lobbying and no political activity, then having majority or even complete overlap between the boards will create little risk. However, especially if the 501(c)(4) will conduct political activity, then it is advisable that at least some directors of each organization are unique to that organization in order to demonstrate that the organizations are independent and the political activities of the 501(c)(4) cannot be attributed to the 501(c)(3). A more legally conservative approach would be to have only a minority of directors on each board overlap with the other board.[9] If there is complete board overlap, then it may help to maintain corporate separation if there are different employees managing each organization.

Separation of Costs

Each organization must pay all of its own operational and program costs. However, it is not necessary that each organization maintain separate office space or employees – these things can be shared between the organizations, as long as each organization pays its full share of the costs. If the two organizations will share costs, it is important that a cost-sharing agreement be in place to document the relationship between the organizations. A 501(c)(4) may pay for activities of the 501(c)(3) but should treat transfers of funds as a grant (or loan) in order to respect the separate corporate form. A 501(c)(3) may even grant funds to the 501(c)(4) for 501(c)(3)-permissible activities. These arrangements are covered in more detail later in this section.

Many organizations will choose to have the 501(c)(4) reimburse the 501(c)(3) for any costs incurred by the 501(c)(4), especially if the 501(c)(3) is already established. This is fine, but the 501(c)(4) must reimburse the 501(c)(3) promptly for the cost of any services so that it does not appear that the 501(c)(3) is subsidizing the cost of any of the 501(c)(4)'s work. If possible, the 501(c)(4) can pay costs to the 501(c)(3) in advance. If necessary, the 501(c)(3) can provide a commercially-reasonable loan to the 501(c)(4), but a loan must clearly be documented as such by both organizations. The 501(c)(3) must never make a loan to the 501(c)(4) for electoral expenditures. The 501(c)(3) may also make grants to the 501(c)(4) for activities that could be carried out by the 501(c)(3) as long as the grant is properly documented.

Staff Costs

Employees may work entirely for one organization or the other, or they may split their time. If they split their time, it is essential that the organizations keep track of how much time and associated cost is being expended on behalf of each organization. For employees who work on discrete projects of the organizations, especially if the time spent fluctuates from month to month, time sheets are a good way to document the time spent working on behalf of each organization. Employees in administrative roles who spend time working on behalf of both organizations may allocate their time based on a reasonable formula – for example, if one person runs payroll for both organizations, the organization may decide to allocate that person's time according to the headcount of the organizations, the overall percentage of hours worked that period between the organizations, or some other reasonable and documented process. Whatever process is used, it should be consistently applied.

[9] If a majority of directors or officers of one organization are also directors or officers of the other organization, then the organizations will need to each complete Schedule R, reporting Related Organizations and Unrelated Partnerships with their annual Form 990 information return.

It is possible either to have each organization directly pay the associated cost of their payroll, or to have one organization pay the costs, and the other organization promptly reimburse their share. Having one organization handle payroll and administration for employees of both organizations is often useful to avoid duplicating costs of systems and staff time. In these circumstances, one organization may designate the other as the "common paymaster", responsible for issuing all paychecks, reporting payroll taxes to the government, and issuing W-2s. The common paymaster relationship allows shared employees to be treated for most purposes as if they have only one employer, the common paymaster. This means, for instance, that an employee who is employed by two organizational employers concurrently would only be subject to a single FICA wage base, for instance. Common paymaster status is only available if the organizations meet one of four tests of relatedness:

(i) the organizations are members of a controlled group of corporations;
(ii) either 50 percent or more of the members of one organization's board of directors are members of the other organization's board of directors or the holders of 50 percent or more of the voting power to select such members are concurrently the holders of more than 50 percent of that power with respect to the other organization;
(iii) 50 percent or more of one organization's officers are concurrently officers of the other organization; or
(iv) 30 percent or more of one organization's employees are concurrently employees of the other organization.[10]

If the two organizations do not meet any of these tests, one organization can apply to become a "payroll agent" for the other using IRS Form 2679. While a payroll agent may manage the payroll for multiple entities, a separate W-2 can be issued for each entity, and minimum FUTA taxes must be submitted for each entity. If your organizations do not qualify for a common paymaster arrangement, discuss with your payroll provider whether a payroll agent relationship is worthwhile.

There are a few quirks to keep in mind if a 501(c)(3) and 501(c)(4) share staff and administer a joint payroll:

- **FUTA:** 501(c)(3)s are generally exempt from paying FUTA (federal unemployment taxes), but 501(c)(4)s are not. A 501(c)(4) must calculate the tax owed on the portion of staff time that it pays for, and the common paymaster must report and pay that tax. In the event that the common paymaster is the 501(c)(3), the 501(c)(4) must reimburse these costs promptly.[11]

[10] 26 CFR § 31.3121(s)-1(b)(1)
[11] There are known technical challenges getting the IRS to accept FUTA taxes on behalf of the 501(c)(4). Because 501(c)(3)s are generally exempt from FUTA, IRS automatic systems will reject a FUTA return filed by a 501(c)(3) common paymaster for time that shared staff worked for the 501(c)(4). Manual intervention by IRS staff is currently required to file such a return. In the alternative, a 501(c)(4) that depends on a 501(c)(3) as its

- **Health Insurance:** Both organizations should ensure that they speak with their benefits providers and that both organizations are covered in health insurance plans. If time worked for both organizations is not counted toward health insurance eligibility, then it is possible that an employee may fall under the hours required for eligibility for the 501(c)(3) plan by working too many hours for the 501(c)(4) in a given week or month. This can usually be navigated by discussing with the benefits provider in advance. Each organization must pay the proportional share of its health insurance costs on a shared plan.
- **Retirement Benefits:** 501(c)(3) organizations may enroll in retirement benefits through 403(b) plans, but these plans are not available to 501(c)(4) organizations. Both organization types may offer 401(k) retirement plans. In order to ensure equity between staff working on behalf of multiple organizations, 401(k) plans offer the best flexibility for related organizations with common administration. Organizations considering sharing employees should carefully look at their plan documents and/or discuss with their administrators to ensure that employees can contribute to their 401(k) based on salary paid by either entity. Additionally, organizations should consider the effect of concurrent employment on any applicable employer match provisions, so that employees who work for both entities are not unfairly disadvantaged.

Whatever methods the organizations use to track and allocate staff time and associated costs, this information should be documented and maintained along with organizational financial records. In the event of an IRS audit, each organization must be able to demonstrate the methodology used to accurately allocate and pay costs.

Office Costs

A 501(c)(3) and 501(c)(4) may share office space and equipment as long as each organization pays for its appropriate share of the costs. As with staff costs, the organizations may use any reasonable methodology to assign a portion of office space costs to each organization, but the methodology should be consistent and documented. When in doubt, it is better to have the 501(c)(4) overpay its share of costs because while the 501(c)(3) cannot offset expenses for the 501(c)(4), it is permissible for the 501(c)(4) to subsidize the 501(c)(3).

Where items, equipment, or supplies can be separated by organization, they should be. For example, a copy machine or postage meter may allow for codes to be input so that each organization can keep separate track of their

common paymaster could file FUTA but that results in other problems: The 501(c)(4) would be unable to submit FUTA taxes online because the 501(c)(3) is the accountholder, and a 501(c)(4) paying its FUTA directly would be unable to claim the allowable deduction for SUTA (state unemployment tax) paid by the 501(c)(3) paymaster (a deduction that can be significant). Until the IRS fixes the processing problem that hinders 501(c)(3) paymasters from paying FUTA taxes on behalf of the related 501(c)(4), the best approach seems to be for the 501(c)(3) to attempt to submit the FUTA taxes on paper, and, if the filing is rejected, refile with an explanation and seek to have the filing referred to a specialist who can manually process the form.

usage. When organizations purchase items clearly intended to be used by one of the entities (for example, food or materials for a fundraising event for one of the entities), then those supplies should be paid for by that entity. Costs of routine office supplies can be shared between the entities according to a reasonable formula. Where it is not feasible to easily separate costs between the 501(c)(3) and 501(c)(4), each organization can pay a proportion of costs according to a reasonable and documented process. Common approaches include allocating office space and associated overhead costs according to the staff time attributed to each organization during the same period or the square footage of office space used by each organization. If one organization reimburses the other organization for a proportion of shared costs, that reimbursement should take place promptly. As with staff time, the methodology used to track expenses and the payments made between the entities should be documented and stored with each organization's financial records.

Many 501(c)(3)s are eligible to send bulk mail at discounted rates ("Nonprofit USPS Marketing Mail") by applying for a special permit. An organization may be eligible for its own nonprofit mail permit if it is a religious, educational, scientific, philanthropic (charitable), agricultural, labor, veterans, or fraternal organization.[12] Most 501(c)(4)s are not eligible for discounted postage and they may not utilize the 501(c)(3)'s mail permit in order to take advantage of the nonprofit rate. A mailing on behalf of both organizations (called a "cooperative mailing") may only take advantage of the special nonprofit rates if both organizations have been authorized to pay the Nonprofit USPS Marketing Mail (nonprofit) prices.

Lists and Fundraising

Each organization must pay for its own contact or mailing lists and fundraising costs, though it is possible for the organizations to work collaboratively. The organizations may run joint fundraising programs, as long as each organization pays their own costs. The costs should be shared based on a reasonable formula: we typically recommend that costs for a fundraising event be allocated based on a share of receipts. A joint fundraising event must not include any 501(c)(3)-prohibited content.

The entities may also manage a joint contact list, as long as each organization uses the list and contributes an appropriate allocation to the cost of building and maintaining such a list. A shared list arrangement should be documented with a written agreement and monitored to ensure that the 501(c)(3)'s efforts to recruit new names to the list are not providing a disproportionate benefit to the 501(c)(4). Alternatively, if the organizations maintain separate lists of donors or activists, the 501(c)(4) may solicit donations from or otherwise communicate with people on the 501(c)(3)'s list, but the 501(c)(4) must pay fair market value to rent the list. There are private vendors that specialize in valuing the cost of lists for organizations that wish to engage in list-sharing or list-swap agreements.

Separation of Activities

In order to ensure that the 501(c)(3) does not subsidize activities of the 501(c)(4), it is

[12] United States Postal Service, Publication 417. Available at: https://pe.usps.com/cpim/ftp/pubs/Pub417/pub417.pdf

important that each organization conduct and pay for its own distinct activities.

Some activities could legally be conducted by either entity. A 501(c)(3) can conduct some lobbying, and a 501(c)(4) can conduct any activity that a 501(c)(3) can conduct. Because the nature of the activity cannot always be used to determine which entity is paying for the activity on its own, it is important that the organizations decide ahead of time which entity will pay for a particular activity, and then the organizations must pay for and brand the activity appropriately. If one entity will pay for an activity carried out in the name of the other, that payment should be treated as a grant, limited to appropriate purposes, and documented as such.

Organizational Branding

Your 501(c)(3) and 501(c)(4) organization should each have their own distinct name and identity. If the organizations are related (formally or informally), it is fine if the names between the organizations are similar as long as they can be distinguished from one another. Many organizations choose to use the phrase "Education" or "Education Fund" to identify their 501(c)(3), and/or "Action" or "Action Fund" to identify their 501(c)(4). Because nonprofits will often want to refer to the 501(c)(3) and 501(c)(4) collectively, it can be helpful to pick names that lend themselves to a common shorthand that can encompass both. If the Dragon Lovers Alliance for Research and Education establishes a related advocacy arm called Dragon Lovers Alliance for Action and Advocacy, the two together can be referred to as "Dragon Lovers Alliance," with the full name (or initialism/acronym) of each entity being used where it is important to identify the specific corporation. It is best to avoid a shorthand name that mirrors the legal name of one of the two entities, because this can create confusion when the shorthand is used for the combined "us" sometimes, and for the specific corporation in other contexts. Branding for the organizations should also be distinct and clearly identifiable – ideally the organizations would have logos that offer clear visual cues about which organization is being referenced.

Website

In an ideal world from the legal perspective, each organization would have a distinct website that describes the organization and its activities, hosted at its own domain name. If the organizations must share a website, then each website should have its own section of the site and its own branding so that the user can always clearly tell which organization's content they are viewing. Each entity must also pay a proportional cost for the website. If the organizations share a website, then the 501(c)(4) may not post candidate endorsements or other overtly political activity on the shared website. This may jeopardize the 501(c)(3)'s tax-exempt status.

If the organizations host separate websites, then they can be linked together but this should be done with care. The 501(c)(3) website can link to the 501(c)(4) website but not link to any page that endorses candidates or otherwise engages in political intervention. It is generally considered safe to link to the sister organization's home page, and mutual links to a website's "About Us" section would probably also be reasonable.[13] The 501(c)(3) absolutely should not link to content that creates the perception that the 501(c)(3) endorses candidates. Even to the extent that the 501(c)(3) links to completely separate websites, it bears the responsibility to regularly check the content of those websites to ensure that the 501(c)(3) does not create the appearance that it is engaging in impermissible political intervention.

Sometimes 501(c)(4) organizations will post grassroots lobbying statements on their websites, and, although 501(c)(3) organizations can engage in such lobbying, they should be mindful that any links to those pages of the 501(c)(4) website may be attributed to the 501(c)(3) organization.

Donation pages must contain the proper disclaimers – while donations to a 501(c)(3) are tax-deductible as charitable contributions to the donor[14], donations to a 501(c)(4) are not tax deductible on this basis and most 501(c)(4)s are required to notify prospective donors of this fact on their solicitations (including websites).

Assigning Activities to Entities

In general, any activity that is part of a 501(c)(4)'s "exempt purpose" can also be conducted by a 501(c)(3) – lobbying limits notwithstanding. As a result, many activities can be conducted by either the 501(c)(3) or 501(c)(4) depending on the organizations' strategy and requirements. Though the 501(c)(4) can conduct a broader array of activities, like unlimited lobbying or limited political intervention, at times it may make sense to have the 501(c)(4) conduct activity that could be completed by the 501(c)(3). For example, if the 501(c)(4) conducts extensive political activity, then it may make sense to shift some 501(c)(3)-permissible work into the 501(c)(4) to ensure that the 501(c)(4) maintains an appropriate balance of social welfare activity.

The 501(c)(3) can even provide funding to the 501(c)(4), as long as the 501(c)(3) does not fund the 501(c)(4) to conduct any activities that the 501(c)(3) could not otherwise conduct on its own. For example, the 501(c)(3) could make a grant to the 501(c)(4) that covers lobbying expenses. However, lobbying grants from a 501(c)(3) to a 501(c)(4) will be presumed to go against the 501(c)(3)'s *grassroots* lobbying limit unless appropriate restrictions are imposed and the 501(c)(3) can demonstrate that its funds were used for direct and not grassroots lobbying. If the 501(c)(4) ultimately spends less than the amount of the full grant on its grassroots lobbying expenses for the year, then the remainder will count toward the 501(c)(3)'s

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[13] In an internal memorandum issued in 2008, the IRS Director of Exempt Organizations indicated that in the case of related organizations, the IRS will not pursue cases where a 501(c)(3) links to the home page of a related 501(c)(4). (See IRS Memo "2008 Political Campaign Season", 4/17/2008, available at: https://www.irs.gov/pub/irs-tege/2008_paci_program_letter.pdf)

[14] In general, contributions to charitable organizations may be deducted up to 50 percent of adjusted gross income; however, contributions to certain private foundations, veterans' organizations, fraternal societies, and cometary organizations are limited to 30% of adjusted gross income. Where something of value is provided in exchange for the contribution, the donor may only deduct the portion of the contribution above and beyond the fair market value of the item. More information is available at: https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contribution-deductions and https://www.irs.gov/charities-non-profits/substantiating-charitable-contributions

direct lobbying limit. If the grant totals more than the 501(c)(4) spends on both direct and grassroots lobbying for the year combined, then any remaining funds will not count to the 501(c)(3) as lobbying expenses. The grant agreement should ensure that the 501(c)(4) tracks and reports lobbying expenses back to the 501(c)(3), so that the 501(c)(3) can report the expenses appropriately on its annual 990. The 501(c)(3) may alternately make "controlled" grants to the 501(c)(4) that permit only 501(c)(3)-permissible activity and do not allow any lobbying activity. Grants from the 501(c)(3) to the 501(c)(4) should always be accompanied by a written grant agreement outlining the purpose of the grant and permissible use of funds.

The 501(c)(4) may also grant unlimited money to the 501(c)(3); a written grant agreement is advisable both to observe the separate corporate status of the entities and to document the transaction for accounting purposes. Because a 501(c)(4) may contribute to a 501(c)(3), a 501(c)(4) is also permitted to make a loan to a 501(c)(3). The loan should be documented so that repayments from the 501(c)(3) to the 501(c)(4) can be attached to the loan and do not appear to be impermissible transfers of funds. Loans from 501(c)(3)s to 501(c)(4)s are also permitted but must be made according to commercially-reasonable terms, must be carefully documented, and loan proceeds must not be used for political activities of the 501(c)(4).

Joint Activity

The 501(c)(3) and 501(c)(4) may occasionally participate in joint programming but must do so carefully. Both the 501(c)(3) and 501(c)(4) may conduct lobbying, so it is possible for them to conduct a joint program involving lobbying. If they do a joint lobbying project, the 501(c)(3) must be conscious of its lobbying limits and to not exceed its cap. As with all activities where money moves between the 501(c)(3) and 501(c)(4), the organizations should keep detailed records of spending so that the amount attributable to each organization is clearly documented.

Even though the 501(c)(3) can participate in some non-partisan electoral activity (i.e., non-partisan voter education and engagement), it is recommended that the 501(c)(3) and 501(c)(4) separate this activity as much as possible so that there is no appearance that the 501(c)(3) may be contributing to impermissible campaign intervention. For example, if the 501(c)(3) were to engage in voter registration or non-partisan GOTV activities in the same geography where the 501(c)(4) had endorsed candidates, it would create the possibility (or perception) of the 501(c)(3)'s activities being targeted to help elect particular candidates. Even though a 501(c)(3) can participate in non-partisan voter education and engagement, if the 501(c)(3) plans this electoral activity to complement the 501(c)(4)'s political work, the IRS may determine that the 501(c)(3) engaged in impermissible campaign intervention based on the "facts and circumstances" test. For example, if a 501(c)(4) intends to engage in independent expenditure communications in a particular election, and the 501(c)(3) also runs a voter registration or non-partisan get-out-the-vote program in the same district, then the IRS may find that the 501(c)(3) impermissibly coordinated its plans to support the 501(c)(4)'s political work. Programming decisions made completely independently by the 501(c)(3) and 501(c)(4) might be justifiable if they are clearly documented and managed independently, but joint activities could be particularly problematic.

The 501(c)(3) should also take care not to contribute material resources to the 501(c)(4) that are used for impermissible partisan intervention. The 501(c)(3) can produce materials in line with its charitable purpose, and if those materials happen to be used later by the 501(c)(4), this might be permissible. However, if the 501(c)(3) were to create resources and share them only for the 501(c)(4) to use in electoral programming, this would be a problem. For example, if the 501(c)(3) did research and created a report that was not shared publicly but was given to the 501(c)(4) as background to develop messaging for the 501(c)(4)'s electoral program, this would be impermissible campaign intervention by the 501(c)(3).

DO I NEED A PAC OR A 527?

If your organization hopes to engage in substantial political activity, it may be worth creating a Political Action Committee or 527 organization to engage explicitly in this work. Generally, a 501(c)(3) cannot create an affiliated political organization, but a 501(c)(4) can. Furthermore, a 501(c)(4) can count administrative costs and fundraising activity for a connected political committee toward the 501(c)(4)'s exempt purpose.

What is a 527?

Section 527 of the IRC describes political organizations formed for the purpose of "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local political office,"[15] including the selection of President, Vice President, and political party offices. There are a variety of types of 527s, including federal PACs (political action committees) that register with the FEC and intervene in federal elections, analogous state PACs governed under state law, and other types of 527s that are not required to register under campaign finance laws.

If your organization plans to do extensive political work, then creating a 527 might be an effective way to execute that work without running afoul of the 501(c)(4) primary purpose test. A 501(c)(4) must be operated "primarily" for exempt purposes, which does not include political activity.[16] Though a 501(c)(4) may engage in some political intervention, spending a substantial portion of its resources on campaign intervention could result in tax liability or even loss of tax exemption.

527s can take a variety of forms to either contribute directly to or coordinate with a federal candidate in limited amounts, or to spend an unlimited amount of money "independently." Campaign activities for federal office (President, Congress, the U.S. Senate) are regulated by the Federal Election Commission.

Neither a 501(c)(3) nor a 501(c)(4) can make any direct or in-kind contributions to a federal candidate. However, some 527s can make such contributions. A traditional federal PAC is registered with the FEC and may make contributions directly to federal candidates. Donations to traditional federal PACs are subject to individual contribution limits. A PAC may qualify as a multi-candidate PAC if it has been registered with the FEC for at least six months, has more than fifty contributors, and has made contributions to at least five candidates for federal office. Multi-candidate PACs can contribute almost twice as much per

[15] 26 U.S.C. 527(e)(2)
[16] Treas. Reg. § 1.501(c)(4)-1(2)(ii)

cycle to each candidate they support. A 501(c)(4) can establish and pay for the fundraising and administrative expenses of a federal PAC by establishing a "connected organization" or "separate segregated fund" and these costs will count toward the 501(c)(4)'s exempt purpose. The sponsoring organization may not contribute general treasury funds to their connected PAC and may only solicit contributions from a restricted class (bona fide members, executive and administrative personnel, and their families). A connected PAC may not be established by a 501(c)(3).

Both traditional and Super PACs can make independent expenditures, which are express advocacy communications that are not coordinated with or approved by a candidate or party. Super PACs may only make independent expenditures – they may not make contributions to or coordinate with candidates. Super PACs may be created as non-connected PACs, and may raise funds from the general public, including corporations and labor unions. A 501(c)(4) may pay for the administrative and fundraising costs of a nonconnected PAC, but those costs will be treated as in-kind contributions and may not be part of the 501(c)(4)'s exempt purpose. Independent expenditures are not subject to contribution limits, and therefore entities that make these expenditures can spend an unlimited amount as long as they properly report. 501(c)(4)s may also conduct independent expenditures as long as their primary purpose remains social welfare. However, a court case in 2018[17] opened some 501(c)(4)s that engage in independent expenditure activity to the obligation to disclose their political donors to the FEC.[18] At the time of publication, the FEC has not issued further guidance clarifying the contributions that must be disclosed, and the FEC has no quorum to provide additional clarity on this matter.

Campaigns for state or local office (governor, elected constitutional offices, state legislature, city council, and other offices) are regulated by state and sometimes local campaign finance government agencies. Before engaging in any campaign finance activity for state or local office (including fundraising for such activity), it is critical to research state election law or consult knowledgeable counsel.

Donations to 527 organizations have additional compliance requirements. While foreigners (non-U.S. citizens other than green card holders) may donate to 501(c)(4)s, they may not contribute to efforts to intervene in U.S. politics and 501(c)(4)s and 527s must not knowingly accept contributions for political activity from foreign donors. Any donations that are solicited explicitly for planned political programs of the 501(c)(4), or donations to a 527, should ask contributors to certify that they are U.S. citizens or green card holders.

STATE LAW CONSIDERATIONS

In many cases, state laws reflect or parallel federal laws regarding political and advocacy activity; however, each state also has aspects that make its rules unique. The definition of lobbying activity may vary across states and

[17] *CREW v. FEC,* 316 F. Supp 3d 349 (D.D.C. 2018)

[18] For more information, please see: Rich Eisenberg. "FEC Issues New Guidance on 501(c)(4) Independent Expenditure Reporting." Harmon Curran Nonprofit Law Blog, 10/11/2018, accessible at: https://www.harmoncurran.com/fec-issues-new-guidance-on-501c4-independent-expenditure-reporting/

municipalities, and many states have requirements to register, report, or disclose funding for lobbying activity in ways that go far beyond the requirements to lobby the federal government.

Likewise, the regulations applying to state-level political intervention can vary widely. Most states recognize a structure similar to a federal Super PAC, but some states require such independent expenditure-only committees to register and operate local entities or subject them to additional reporting requirements. Other states allow for much greater degrees of coordination between candidates and outside groups than is allowed at the federal level. For example, Virginia allows corporations to make unlimited contributions to candidates as long as those contributions are disclosed; Texas allows political action committees to contribute an unlimited amount to state-level candidates. Efforts that focus on both state and federal campaigns may require a joint effort of multiple entities.

Campaigning around ballot measures is another activity that is regulated differently from state to state. From a federal tax perspective, ballot measure advocacy will generally be treated as direct lobbying, because the voter has the power to directly pass legislation though the ballot measure process. In some circumstances, political organizations may also be able to engage in ballot measure campaigns and count them toward their primary purpose of electoral expenditures, where that activity enhances their primary purpose political engagement.[19] However, some states have additional restrictions and requirements to engage in ballot measure campaigns, including registration and reporting requirements.

It is critical that any organization planning to engage in advocacy about a ballot measure research these requirements before undertaking this work. Even raising funds for activities that have not yet taken place can trigger state registration and disclosure obligations. Because state and even municipal laws can vary substantially, we strongly recommend consulting an attorney who is knowledgeable in these fields before engaging in state or local advocacy and electoral work.

CONCLUSION

Launching a 501(c)(4) can expand the tools available to a nonprofit to complete its work and make change for its constituents. Adding a 501(c)(4) will necessarily create additional work for staff and leadership, from technical tracking to additional reporting to managing separate boards and budgets. However, many organizations find that the added flexibility to

[19] In a Private Letter Ruling, the IRS determined that the following campaign efforts around ballot measures were permissible 527 activity: (i) linking candidates and ballot measures to enhance the effectiveness of candidate-specific work; (ii) using ballot measures to encourage candidates to take a stance on an issue, thus more efficiently influencing the election of many candidates at once; (iii) engaging in ballot measures as a tool to influence prospective donors to channel resources toward supported candidates and away from opposed candidates; (iv) engaging in ballot measures that would effect the rules of the electoral process, and thus impact the future efficacy of candidate-centric campaign activities; and (v) campaigning on ballot measures for the purpose of increasing turnout for pro-issue candidates. I.R.S. Priv. Ltr. Rul. 199925051. Private Letter Rulings are issued in response to specific requests and relate to particular circumstances of the requesting organization, and outside organizations are not entitled to rely on PLRs as precedential. However, they can be useful to inform us of the IRS's thinking on particular topics.

conduct more lobbying or some electoral intervention is worth the trade-off. We hope that this brief guide has given you the information you need to weigh these costs and benefits and to assess whether launching ancillary organizations may be worthwhile for your unique context.