

# The Details Matter: Carefully Operating Related 501(c)(3) and 501(c)(4) Nonprofits

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The IRS recently denied 501(c)(3) public charity status to a social justice organization that was related to a 501(c)(4) social welfare organization. (*PLR 201408030*) What went wrong? Plenty, with much to learn for nonprofit organizations seeking to navigate the increasingly choppy waters of politically tinged activities.

Given the increasingly choppy waters of politically-tinged activities, closely related 501(c)(3) and 501(c)(4) organizations should be very attentive to the small things to ensure their larger missions do not similarly get derailed.

## **Start with the Basics**

First, remember that 501(c)(3) organizations must be charitable, in order to qualify for the privilege of receiving tax-deductible contributions. More specifically, they must be both organized (i.e., on paper) and operated (the real deal) primarily for specific qualified purposes (religious, educational, charitable, etc.). Any other activities may only be “insubstantial” in relation to the whole, including lobbying.

Second, keep in mind that a public charity needs to carefully maintain its independent identity. If its leaders want to collaborate with other organizations that do not share such privileged tax status, whether they are social welfare organizations or even for-profits, they

must protect the public charity's assets and avoid line-blurring between the organizations' activities, internal operations, and control.

## **Too Much for the IRS**

So what did the public charity applicant do wrong? Concluding that the applicant organization cumulatively was not charitable enough for 501(c)(3) status, the IRS honed in on the following organizational and operational defects.

1. The applicant shared its educational "research" information with "N," its related 501(c)(4) organization, particularly to help further the 501(c)(4) organization's impact on legislatures.
2. The applicant's work plan explicitly identified the goal of influencing legislators.
3. The applicant shared facilities, staff, and office equipment with "N," without sufficiently distinguishing between activities that should have been separately attributable to each entity.
4. A majority of the applicant's board was appointed by "N," thereby giving "N" control over it.
5. The applicant served as a fiscal sponsor for "N" projects, and even provided grants to "N," using charitable funds for activities beyond its own tax-exempt charitable purposes.
6. Certain "educational" activities occurred close in time and proximity to legislative activity on the same issues.

## **Lessons Learned**

This case may be fairly egregious in terms of the applicant's excessive lobbying activity and line-blurring, but it provides important lessons for public charities, particularly those involved with politically-related activities, as follows.

First, remember the IRS enforces fairly narrow limits on lobbying. The question of when an organization "substantially" engages in lobbying, so that it is subject to loss of 501(c)(3) status, is not easy to answer. What is enough? It is hard to say. An organization should weigh its need to engage in lobbying against the potential adverse consequences of being found to have engaged in too much lobbying. As the applicant learned here, even filing the "IRS Section (h)" lobbying election may not protect a public charity if it is found to engage in "substantial" lobbying.

Second, keep one's distance. A public charity's privileged tax-exempt status is too precious to risk losing through inattentiveness in allocating responsibilities and expenditures between it and other organizations with which it collaborates. If a public charity operates in conjunction with a related social welfare organization, then the organizations should strictly separate their goals, functions, and activities – on paper, in practice, in their publicity, everywhere.

Third, avoid any actual or potential control of a public charity by a different type of organization. Ideally, related 501(c)(3) and 501(c)(4) organizations should not have co-extensive boards with identical leadership. Rather, a significant percentage of each board's leadership should not serve on the other board, at least enough to help avoid conflicts of interests and those blurred lines between the organizations.

Fourth, be mindful of express limits on politically related activities. For new nonprofits seeking recognition of tax-exempt status, awareness of such limits is crucial. It can be quite challenging for an issue-oriented public charity to steer clear of prohibited political campaign activities and applicable lobbying restrictions. But the Internal Revenue Code strictly prohibits certain politically oriented activities. Involvement in such prohibited activities could jeopardize the organization's precious tax-exempt status. If there is any question about whether an organization's proposed activity is so prohibited, the entity should see legal advice from a qualified attorney with experience in advising such clients.

Fifth, public charities should focus on changing hearts, minds, culture, and people's views through educational advocacy. Even without such political activities, a (c)(3)'s education efforts may yield significant cultural and political changes, whether soon or in the long-term. Therefore, a (c)(3) should strive to be non-partisan. (Such an approach also may help organizations appeal to more donors on both sides of the proverbial aisle.)



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