Chapter II: Establishing and Operating Affiliated 501(c)(3) and 501(c)(4) Organizations

THE CONNECTION

Strategies for Creating and Operating 501(c)(3)s, 501(c)(4)s and Political Organizations

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CONTENTS

CHAPTER II: ESTABLISHING AND OPERATING AFFILIATED 501(C)(3) AND 501(C)(4) ORGANIZATIONS

Given the ability of 501(c)(4)s to engage in extensive lobbying and some political activities, a 501(c)(3) active on public policy issues might consider establishing an affiliated 501(c)(4). This section will explain how to establish a 501(c)(4) and how to manage the allocation of resources between a 501(c)(3) and a 501(c)(4). The guidelines are also applicable to a 501(c)(4) that wishes to establish a 501(c)(3) in order to conduct research and other charitable activities.

A. ESTABLISHING AND OPERATING A 501(C)(4)

In *Regan v. Taxation with Representation*,[1] the Supreme Court ruled that a 501(c)(3) organization may establish a separate 501(c)(4) to expand its capacity to lobby beyond the limited expenditures allowed for 501(c)(3)s. While it may not be worthwhile to set up a separate organization for a one-time lobbying campaign, there are clear advantages to creating a 501(c)(4) for longer-term lobbying efforts. Unlike a 501(c)(3), a 501(c)(4) may engage in unlimited lobbying on ballot measures and in legislative bodies without jeopardizing its exempt status. And, as noted above, a 501(c)(4) may conduct limited partisan election-related activities and may set up a connected political organization. Many organizations manage multiple related entities—even a 501(c)(3), a 501(c)(4), and 527 organizations—successfully. The key is that the 501(c)(3) must be able to demonstrate that it is not subsidizing, directly or indirectly, the political work of its affiliated 501(c)(4) or related political organizations.

This section discusses the considerations and steps that are advisable when one is establishing an affiliated 501(c)(4). The considerations vary depending on whether the 501(c)(4) only conducts lobbying or also engages in political activities.

Checklist for Setting Up a 501(c)(4) Social Welfare Organization

(Get a knowledgeable lawyer to help with these steps.)

- Identify the intended purposes. Do they satisfy 501(c)(4) requirements? (See the Introduction to this guide for discussion of each type of tax exemption.)
- Decide whether to incorporate the organization or organize it as an unincorporated association under state law. A 501(c)(4) may be organized as a trust, an unincorporated association, or a corporation. Contact the Secretary of State for procedures on incorporation or on establishing a nonprofit association if that structure is available in your state.
- Apply for an Employer Identification Number (EIN) using IRS Form SS-4, "Application for Employer Identification Number."
- Prepare bylaws. Many companies sell standard bylaws for use by lawyers or non-lawyers, and some states have sample bylaws on the Secretary of State's website. See BolderAdvocacy.org for an example of bylaws for a 501(c)(4).
- Hold an organizational board meeting to elect officers, adopt bylaws, and authorize officers and employees to open bank accounts and sign contracts.
- Establish a bank account.
- Research and follow other requirements in state law regarding corporate and tax compliance.
- Identify an accountant, counsel, or other person to maintain records and ensure corporate compliance, including filing an annual information return on IRS Form 990, "Return of Organization Exempt from Income Tax."
- For a 501(c)(4), file IRS Form 1024, "Application for Recognition of Exemption Under section 501(a)." See BolderAdvocacy.org for a sample Form 1024. While a 501(c)(4) organization is not required to file a Form 1024, by filing the application the organization may get formal recognition of tax-exempt status from the IRS.
- File any required applications for tax-exempt status under state law.
- If the (c)(4) is affiliated with a (c)(3), prepare a cost-sharing or allocation agreement. See Appendix B.

1. Corporate Structure, Board of Directors, and Officers

The 501(c)(3) board of directors may wish to pass a resolution authorizing certain individuals to establish a 501(c)(4), or a group of individuals associated with the 501(c)(3) may proceed without a board resolution. In either case, a 501(c)(4) must be established as a legal entity separate from the 501(c)(3). This separation is generally accomplished by incorporating the 501(c)(4). Incorporation provides numerous other advantages, such as limiting directors' and officers' liability for the organization's actions. Incorporating an organization under state law is generally simple. Information, forms, and instructions are available in most states through the Secretary of State's office.[2] A listing of these offices is available from the National Association of Secretaries of State at http://www.nass.org/busreg/corpreg.html. An example of articles of incorporation, bylaws, and the Form 1024 (the application for tax-exempt status) is provided on Alliance for Justice's website, BolderAdvocacy.org.

The 501(c)(4) should have a board of directors separate from that of the 501(c)(3). The boards must operate separately, holding distinct meetings and maintaining separate minutes of their meetings. When the need arises, the members of one board may attend the meetings of the other board as guests, except when a board is meeting in executive session.

Example:

PEN holds its meetings in the morning on the first day of every other month. Minutes are recorded for the 501(c)(4) meeting. That meeting is adjourned, and those individuals who serve as directors of the PEN Education Fund start their meeting to discuss Fund business. Minutes of the second meeting are recorded separately for the 501(c)(3).

If the 501(c)(4) conducts lobbying activities but does not engage in political activities, little risk exists in allowing the same individuals to serve on the boards of both the 501(c)(3) and the 501(c)(4). If, however, the 501(c)(4) conducts political activities, greater corporate separation is advisable between the 501(c)(3) and 501(c)(4) to reduce the chance that the political activities of the 501(c)(4) will be attributed to the 501(c)(3) or taint the nonpartisan election activities of the 501(c)(3). Separation of the boards is one factor in demonstrating independence. Therefore, it is especially advisable in this situation to have some members of the 501(c)(3) board who are not on the 501(c)(4) board if the 501(c)(4) plans to engage in political activity.

The 501(c)(4) board must elect its own officers and must govern the 501(c)(4) as a separate entity in every respect. Each organization must file its own separate tax returns, comply with all federal and state reporting requirements, and make its own decisions about its conduct. The 501(c)(4) must pay its own costs, and the 501(c)(4)'s board of directors, officers, and staff must make the organization's decisions.

Certain relationships, shared staff, and grants between the 501(c)(3) and 501(c)(4) must be disclosed on both organizations' Form 990 informational returns. IRS Form 990 is the information return that most 501(c)(3) and 501(c)(4) organizations must file annually with the IRS to disclose financial and program activity.[3] No adverse consequences exist in reporting such an overlap provided that the organizations operate independently and observe legal limits.

In addition, IRS Form 990, Schedule A requires 501(c)(3)s to disclose direct and indirect financial transactions with other exempt organizations, including 501(c)(4)s and, in turn, their connected Federal PACs. The primary purpose of this disclosure is to permit monitoring of the allocation of expenses between related organizations.

The two organizations must maintain separate books, records, and bank accounts, and any transfers between the organizations must be documented. (See Sections B and C of this chapter for more information regarding grants and other transfers of funds between a 501(c)(3) and 501(c)(4).)

2. Naming the New Organization

Affiliated 501(c)(3)s and 501(c)(4)s often have similar names and logos. To demonstrate, the name of the hypothetical 501(c)(3) Protect the Environment Now Education Fund is quite similar to that of Protect the Environment Now, the 501(c)(4) organization. While the two organizations may have similar names, they should be distinguishable. If the organizations are commonly known by acronyms, the letters should not be identical. Too much similarity could cause confusion about the two organizations' fundraising, lobbying, political, and other activities. If the 501(c)(3) owns the name, it may be advisable to have a licensing agreement with the 501(c)(4) setting out the terms and conditions for use of the name. In fact, this approach may be useful regardless of which entity owns the name and logo, as a way for the original organization to manage the risk that an affiliated organization's board of directors might revise that entity's programmatic focus or mission.

3. Shared Employees, Office Space, and Equipment

A 501(c)(4) should reimburse a 501(c)(3), generally within 30 to 60 days, for any advanced costs.

A 501(c)(3) and 501(c)(4) may share employees, equipment, and office space. In fact, the entire staff of the 501(c)(4) could be employees of the 501(c)(3), or vice versa. It is essential, however, that the 501(c)(4) pay at least its full share of all salary, equipment costs, and rent for running the day-to-day operations of the 501(c)(4) in order to ensure that the 501(c)(3) does not subsidize the 501(c)(4).[4] It is also important to put this cost-sharing arrangement in writing and to comply with the terms of the agreement. (See Appendix B for an example of a cost-sharing agreement.)

These costs should be paid regularly and within a reasonable time. While there is no clear IRS guidance on what is reasonable, a 501(c)(4) should reimburse a 501(c)(3), generally within 30 to 60 days, for any advanced costs, such as salaries or rent. (To provide financial support for a longer period, a 501(c)(3) may make commercially reasonable loans to a 501(c)(4) under certain circumstances as described below in Section C of this chapter.)

To protect the 501(c)(3), the 501(c)(4) should err on the side of overpaying its share of the costs when there is any question as to how an expense should be allocated. The flow of funds from a 501(c)(4) to a 501(c)(3) does not result in any significant legal risk, but a 501(c)(3) could jeopardize its tax-exempt status if it subsidizes or pays the expenses of the 501(c)(4). The exception to this rule is that the 501(c)(3) may support charitable activities of the 501(c)(4), subject to a proper grant agreement, as discussed below.

a. Shared Employees

If the two organizations share staff, these employees should keep written records to document the time spent working for each organization so that each organization can pay its share of staff compensation. Completing time records is the best way to support the allocation of salary between the two organizations. If some staff consistently work a certain percentage of time for each organization and that percentage is documented, it may be possible to allocate salary according to that percentage on a continuing basis without continuing to maintain time records. For those staff members who work on projects that frequently change, time sheets should be used for an indefinite period to document any changes in salary allocation.

A 501(c)(3) and 501(c)(4) may generally arrange to have one organization perform the administrative functions and handle payroll as a payroll agent so long as the other organization reimburses the associated costs in a timely manner. One of the major advantages of this arrangement is that employees do not receive multiple paychecks.

Under certain limited circumstances, organizations that share employees may take advantage of the "common paymaster" rules. A major advantage of these rules is that the FICA tax costs, particularly for highly compensated employees, will not be duplicated if the employees work directly for two or more employers. Under these rules, one entity is designated to pay certain employees even though some of their time may be spent performing services for other related organizations. The common paymaster is responsible for maintaining the payroll records for these employees and may pay individuals with one paycheck or with separate paychecks. A common paymaster also has responsibility for (1) payroll taxes to the government, computed as though the common paymaster were the sole employer, and (2) issuing the required forms, such as Form W-2.

The entities sharing a common paymaster must be "related." In this case the term "related" has a different definition from that used for determining relatedness for purposes of the Form 990 discussed above. In the case of a tax-exempt organization, one or more of the following tests must be met: (1) at least 30 percent of the employees of one corporation are concurrently employed by the other corporation, (2) at least 50 percent of the officers of one corporation are officers of the other corporation, or (3) at least 50 percent of the board of directors of one corporation also serve on the board of the other corporation. In addition, organizations may operate under these rules only if employees are shared with the common paymaster organization. An organization may not serve as a common paymaster for employees who do no work for that organization. All payments made to employees must be through a single legal entity. Finally, the organizations must designate the common paymaster in writing.[5] While the designation need not be filed with the IRS, it must be maintained with the accounting records.

The common paymaster may pay individuals with one paycheck or with separate paychecks drawn on the accounts of one or more of the employing entities.

As an alternative to reimbursement, each organization may pay its share of an employee's salary and benefits separately, with each employee receiving two paychecks. This system may be more burdensome and costly because each organization must prepare separate checks or payments, and, as discussed above, it may involve higher payroll taxes.

Example:

The Education Fund and PEN are related and share employees on a regular basis. The Executive Director of the Education Fund typically spends 75 percent of her time on the Education Fund and 25 percent on PEN activities. The Field Director typically works 70 percent of his time for the Education Fund and 30 percent for PEN. These allocations are based on time reports maintained by the employees. Both employees are paid their full salary by the Education Fund. PEN reimburses or advances the funds to the Education Fund to cover the salary and benefits attributable to the time that each employee spends working for PEN. PEN and the Education Fund establish and adhere to a written agreement to document the allocation methods and payments.

Supplying program staff with a standard timesheet may help them to keep track of how they have split their time among 501(c)(3), 501(c)(4), and other activities. This step will also streamline an organization's administrative compliance efforts. The sample timesheet provided below may be adapted to match the entities affiliated with an organization and activities generally undertaken by staff.

If the 501(c)(4) conducts political activities or has a PAC or 527, the need for timekeeping for shared employees is even more critical. Two principal issues are presented: (1) the organizations must maintain sufficient records to demonstrate that the 501(c)(3) is not financing prohibited political work, and (2) the 501(c)(3) may not directly or indirectly support the political work of the 501(c)(4), PAC, or 527. Sharing staff increases the burden of demonstrating to the IRS that there is no direct or indirect support.

The costs of support staff may be allocated on a “reasonable basis.” While the IRS provides little specific guidance for allocation of support staff, it is clear that there must be a well-documented, specific, and reasonable allocation of expenses. The goal is to split the costs according to use by each organization. For example, the wages of a receptionist who answers phones for both organizations may be allocated based on the number of lines for professional staff or calls answered for each organization, time records maintained for a representative trial period, an allocation ratio based on overhead and administrative expenses, or some other rational measure.

Sample Timesheet for Use by Multiple Related Organizations

Name: ______________________________ Dates: ________________

	501(c)(3)	501(c)(4)	PAC	Total Hours
	Hours Spent/Description of Activities*			
Monday				
Tuesday				
Wednesday				
Thursday				
Friday				
Weekend				
Total Hours				

* See Activity Code for assistance. Enter multiple codes (and hours) if applicable.

Activity Code:
01 Educational Activity
02 Direct Lobbying
03 Grassroots Lobbying
04 Voter Education
05 Partisan Communications with Members
06 Electoral – Federal
07 Electoral – State
08 Administrative
09 Fundraising
10 Special Project (describe)

b. Employee Benefits

As described above, it is frequently advantageous to have all employees working for one organization with the related entity reimbursing that organization for its prorated share of the employees’ salaries and benefits. In this case, health insurance and other employee benefits may generally be offered by the employing organization, and these costs would be calculated into the payments from the related organization. In order to ensure that the employees qualify for these benefits, however, it is important to review the plan documents establishing the benefits to confirm that they cover all employees, including shared employees.

Both 501(c)(3)s and 501(c)(4)s may establish retirement plans enabling their employees to defer income for tax purposes. While it may be possible for two organizations to share a retirement plan, again it is essential to review the proposed plan to ensure that shared employees are covered and meet the qualifications (especially minimum hour requirements) under the plan document.

c. Office Space and Equipment

A 501(c)(3) and 501(c)(4) may also share office space and equipment. Again, the 501(c)(4) must pay its full share of the expenses, which should be carefully documented. The 501(c)(4) may sublease office space from the 501(c)(3) or pay its share of the rent separately to the landlord. Alternatively, the 501(c)(4) may pay the rent for both organizations and allow the 501(c)(3) to occupy the space rent-free.

Each organization's share of the office and equipment must be calculated on a reasonable basis and documented. The IRS provides no specific guidance on allocating costs, but possible measures include assigning each organization a percentage of the cost equal to its share of staff time, staff payroll, or office space used. For example, if the 501(c)(3) pays 60 percent of the total salaries of the employees and the 501(c)(4) pays 40 percent, the rent and overhead might also be divided proportionately. As with the rent, the 501(c)(4) could pay for all of the costs, but the 501(c)(3) may not subsidize the costs of the 501(c)(4).

Common space may be shared, but each organization must pay for its use of the space. For example, if a conference room is used by both the 501(c)(3) and the 501(c)(4), the organizations may share the cost according to the amount of time that each one uses this space, or they can calculate the cost based on the percentage of overhead for each organization. Whatever arrangement is used, the organizations should document the basis for the allocation and revisit it periodically to ensure its accuracy.[6]

The 501(c)(4) could pay for all of the costs, but the 501(c)(3) may not subsidize the costs of the 501(c)(4).

Sharing of equipment may be structured in a similar manner, with each organization paying for its own use. In the case of a copying machine, for example, each organization could have its own code to record use and pay at the end of each month at a rate that recognizes the original purchase cost and maintenance cost of the machine. Similarly, long-distance charges, faxes, and other costs should be paid by each organization, preferably based on actual use, but at least divided on a documented, rational basis as part of overhead. If possible, each organization should arrange to receive a phone bill for long-distance charges and other costs that would be paid directly to the phone company.

Example:

PEN and the Education Fund share staff and a suite of offices. Each organization's share of the rent is based on the percentage of time that the staff works for each organization. While individual members of the staff work different percentages of their time for the two organizations, the blended percentage for the entire staff is 40 percent for PEN and 60 percent for the Education Fund. Therefore, PEN pays 40 percent of the rent and the Education Fund pays the remaining 60 percent.

d. Programmatic Independence

There are few clear rules describing the necessary programmatic separation between related 501(c)(3) and 501(c)(4) organizations. Instead, there is a spectrum of risk, with less separation being riskier for a 501(c)(3), depending on the type of activities conducted by the 501(c)(4). For example, conducting joint lobbying or public education activities with a 501(c)(4) poses minimal risk for the 501(c)(3) because it is permitted to engage in these activities. The 501(c)(3) must, however, be mindful of its lobbying limits. There is considerably more risk in the case of a 501(c)(3)'s conducting nonpartisan voter education or registration activities in the same geographic areas or settings where the related 501(c)(4) is conducting partisan political work.

The 501(c)(3) may not allow a 501(c)(4) to use the 501(c)(3)'s educational materials for partisan political activities. For example, an affiliated 501(c)(4) may not use voting records prepared by the 501(c)(3) for its partisan activities. A 501(c)(3) must monitor and document each activity to avoid any risk of the activity's being transformed from a permissible to an impermissible activity based on subsequent related activities by an affiliated 501(c)(4).

B. GRANTS BETWEEN ORGANIZATIONS

A 501(c)(3) may make grants to a 501(c)(4) (affiliated or unaffiliated) so long as the funds may be used exclusively for educational or other purposes permissible for a 501(c)(3) and the 501(c)(3) receives reports or other documentation showing that this requirement has been honored.[7] The 501(c)(3) may not, under any circumstances, provide funds to the 501(c)(4) that might in any way be used to support the 501(c)(4)'s partisan political activities. The grant

> **Example:**
>
> The Education Fund conducts a nonpartisan voter registration drive. The Education Fund may not give the list of registered voters to PEN or PENPAC. Instead, if permissible under state law, the Education Fund could make its list of registered voters available for sale at a fair-market rate through some form of arm's-length transaction, typically through a broker.

> **Example:**
>
> The Education Fund conducts an educational program on energy independence and the importance of clean and renewable energy to the environment and job creation. It runs ads, does canvassing to educate the public, and prepares reports for the media and policy makers. The program has been a priority for the Fund for two years. Before the election, PEN issues candidate voting records that highlight, among other issues, candidates' positions on energy independence; it also endorses candidates with strong environmental records (including supportive positions on energy issues) and runs ads in support of those candidates and the positions they have taken. PEN does not use any of the same slogans as the Education Fund. The mere fact that there is some overlap in the issue focus of the two organizations would not jeopardize the Fund's exemption as long as the Fund has its own programmatic reasons and goals for working on the issue.

agreement should specifically prohibit the use of the grant for these purposes. Such grants should, therefore, generally be earmarked for specific charitable or educational purposes. They should not cover fundraising expenses of the 501(c)(4). A grant that does not prohibit use of the funds for lobbying will count towards the 501(c)(3)'s grassroots lobbying limits.[8]

> **Example:**
>
> The Education Fund makes a grant to PEN to conduct a research project on chemical releases in five major metropolitan areas and to organize a conference to discuss the report. To support this grant, the Fund prepares a letter of agreement outlining the specific purposes for which the funds may and may not be used, a budget, a schedule for completion, and requirements for reporting grant activities to the Educational Fund. This grant is proper because the activity is one that the 501(c)(3) could permissibly undertake itself.

The 501(c)(3) has financial oversight responsibilities to ensure that its funds are expended on permissible charitable activities. If it fails to do so and the 501(c)(4) engages in lobbying activities with the funds, the 501(c)(3) risks having to treat its entire grant as a lobbying expenditure.[9] Therefore, the 501(c)(4) must document that the 501(c)(3) funds were used for the specific purpose for which they were intended. The two organizations should execute a written grant agreement outlining the purpose of the grant and requesting that the 501(c)(4) provide the 501(c)(3) with periodic reports on exactly how the funds were used. A sample agreement for this type of "controlled grant" may be found in Appendix C.

A 501(c)(3) may also make a grant to a 501(c)(4) to conduct lobbying activities. However, such a grant will count against the 501(c)(3)'s lobbying limits, and, unless the 501(c)(3) takes the necessary precautions, the grant will count against the 501(c)(3)'s limits on grassroots lobbying, not the more generous limit for direct lobbying.[10] The terms of such a grant should be set out in a grant agreement separately from any controlled grant (discussed above) made to the 501(c)(4). A grant made by a 501(c)(3) to a 501(c)(4) to support direct or a combination of direct and grassroots lobbying will count against the 501(c)(3)'s limit on grassroots lobbying activities unless the 501(c)(3) can demonstrate that some or all of the funds were spent on direct lobbying.[11] To avoid having the entire grant treated as grassroots lobbying by the 501(c)(3), the grant agreement must strictly prohibit the use of the funds for grassroots lobbying activities and require that the 501(c)(4) document that the funds were not spent for grassroots lobbying.

Example:

The Education Fund makes a grant of $25,000 to PEN to support PEN's direct and grassroots lobbying on environmental issues. The grant requires that PEN spend no more than $5,000 of the grant for grassroots lobbying and that PEN provide documents to the Education Fund to show that this limit has not been exceeded. The Education Fund would treat this grant as a $5,000 grassroots lobbying expenditure and a $20,000 direct lobbying expenditure. If the grant agreement does not include these provisions, the Education Fund would be required to treat this grant as a $25,000 grassroots lobbying expenditure.

Conversely, the 501(c)(4) may give funds to the 501(c)(3) for any purpose that the 501(c)(3) may legally pursue. Since contributions to the 501(c)(4) are not tax-deductible, no restrictions exist on such transfers. Therefore, the 501(c)(4) may give unlimited funds to the 501(c)(3), directly or indirectly, without jeopardizing either organization's tax-exempt status. While records of such transfers should be maintained, no written agreement is required.

C. LOANS BETWEEN ORGANIZATIONS

A 501(c)(3) may lend funds to a 501(c)(4). A 501(c)(4) may use a loan from a 501(c)(3) for general support or fundraising. However, a 501(c)(3), particularly an affiliated 501(c)(3), should ***not*** lend funds to a 501(c)(4) if the 501(c)(4) plans to use the funds for political activities or if other facts and circumstances would tend to show impermissible 501(c)(3) support for political activity by the 501(c)(4). If a 501(c)(3) lends money to a 501(c)(4), and if the 501(c)(4) then uses the money for political purposes, the 501(c)(3) entity—*as well as the managers who approved the loan*—may be subject to tax on the loan amount, and the 501(c)(3) organization may lose its exempt status.[12]

Any loan made by a 501(c)(3) to a 501(c)(4) should be an arm's-length transaction made at commercially reasonable terms. Therefore, the two organizations should sign a written agreement demonstrating that the loan is made for a definite term, at a market rate of interest, with adequate collateral from the 501(c)(4) (using assets such as its membership list, for example).[13] It is then essential that the organizations comply with the terms of the loan agreement, for a failure by the 501(c)(4) to repay the loan would be interpretable as evidence of an improper transfer from the 501(c)(3).

A 501(c)(4) may make a loan to the 501(c)(3) without such precautions, because it is possible to have the loan treated as a contribution to the 501(c)(3) without any adverse impact on the two organizations' tax status. However, it may nonetheless be advisable to have a written loan agreement if the 501(c)(4) would like to have the funds returned in the future. The agreement would document that the 501(c)(3) was obligated to repay the funds, thereby avoiding questions about why the 501(c)(3) was making the payment when it transferred money to the 501(c)(4) at some future point.

D. FUNDRAISING

1. Initial Start-Up Funding

One of the most difficult hurdles for nonprofit groups is to raise the initial seed money to launch a 501(c)(4). Because many private foundations do not generally fund 501(c)(4)s, fundraising is a much greater challenge than for tax-exempt charitable entities.[14] Nevertheless, there are many avenues of possible support.

One option is for the 501(c)(4) to approach individual donors to the 501(c)(3). A direct mailing or personal solicitation of members or supporters of the 501(c)(3) is probably the best way to begin this process, although donors will not be able to take the tax deductions that they would get by contributing to a 501(c)(3). The 501(c)(4) must rent the 501(c)(3)'s mailing list in order to send direct mail to prospective contributors. To maximize its success, the appeal might focus on two types of donors: those who have reached the ceiling on their charitable deductions and could no longer claim a deduction for contributing to the 501(c)(3) and those who support the mission of the 501(c)(4) and want to fund the more extensive advocacy activities that 501(c)(4)s may undertake.

Example:

The board of directors of the Education Fund sets up PEN. PEN rents the Education Fund's mailing list and sends the Fund's members and contributors a letter stating, "We are setting up a 501(c)(4) organization that will be able to more actively protect the environment in our state. Although you will not be able to claim a tax deduction for your 501(c)(4) contribution, your money will be able to do more than if given to a 501(c)(3), including funding a significant lobbying campaign on our issues."

Other fundraising options for a new 501(c)(4) organization include:

- approaching community foundations and other philanthropies that are not private foundations;
- approaching corporations that may be able to write off their donations as promotional expenses rather than as charitable deductions;
- approaching trade and professional associations, unions, and other noncharitable groups in the community; and
- organizing community canvassing around its lobbying program or holding other events focused on particular issues.

2. Joint Fundraising with a 501(c)(3)

A 501(c)(3) and 501(c)(4) may raise funds jointly, provided that no funds are solicited to support political activities of the 501(c)(4). Each organization must pay its share of the fundraising costs. Therefore, if the solicitation raises funds for both organizations with relatively equal emphasis, the costs could be split equally between the organizations. Another reasonable approach is to allocate the costs of the solicitation based on the ratio of receipts for each organization. Therefore, if the 501(c)(3) raises $60,000 and the 501(c)(4) raises $30,000, the costs of the solicitation could be divided proportionately, assigning two-thirds to the 501(c)(3) and one-third to the 501(c)(4).

Prior to undertaking joint fundraising, the two organizations should agree in writing on the terms: how costs will be allocated, including related expenses such as staff time and materials; what services the organization collecting the funds will perform; and the amount that the other organization will pay for these services.

Example:

PEN and the Education Fund send out a joint fundraising letter describing the Education Fund's research and educational activities as well as PEN's lobbying program. Contributors are invited to write separate checks to the Education Fund and PEN. Alternately, the contributor could be given the choice of dividing the contribution between PEN and the Fund by sending a single check to PEN and designating on the reply card how much of the contribution should go to each organization. PEN would deposit the funds according to the contributor's designation. Only the contribution designated for the Fund is tax-deductible. PEN is required to inform prospective donors that contributions and gifts to PEN are not deductible for federal income tax purposes.

Joint solicitations may make reference to the 501(c)(3) as an organization "related to" or "affiliated with" the 501(c)(4) and should discuss each organization's activities and, to the extent possible, distinguish between their programs. Contributors to the 501(c)(3) should be informed that contributions will be used to support research and nonpartisan studies about current issues or some other charitable purpose. Similarly, contributors should be informed that donations to the 501(c)(4) will support lobbying or other activities.

However, a 501(c)(4) soliciting funds expressly for political activities or its PAC should not do so in a communication that also requests funds for a 501(c)(3). The IRS has said that any joint fundraising will be carefully scrutinized to determine whether the 501(c)(3) is allowing its name or goodwill to be used to further an activity that the 501(c)(3) is prohibited from conducting.[15]

Each organization is required to comply separately with the charitable solicitation registration and reporting requirements applicable under state law.

E. MANAGING PUBLICATIONS, LISTS, AND JOINT WEBSITES

1. Publications

If the 501(c)(3) generally requires that an outside group pay for the use of space in its publication, the same terms should apply to the affiliated 501(c)(4). If the 501(c)(3) allows other organizations to submit occasional articles or to run announcements of activities in the publication free of charge, that same courtesy may be extended to the 501(c)(4), subject to one exception: the 501(c)(3) should not allow any organization, whether related or unrelated, to place material in the publication for free that the 501(c)(3) could not publish on its own under its tax-exempt status. In particular, a 501(c)(3) should avoid running articles about partisan political activities in its magazine or other publication for free.

If a related 501(c)(3) or 501(c)(4) has a magazine or other publication, the sponsoring organization may allow the other organization to pay for its share of the content of each issue. Again, if any charitable funds are used to pay for some portion of the publication, it is generally advisable not to have any partisan content in the publication.

Example:

PEN would like to publish several articles in the PEN Education Fund's quarterly magazine. The articles discuss PEN's grassroots lobbying campaigns. The Fund may publish these articles and charge PEN the fair market value of the cost of the allocable portion of the magazine to avoid having the costs count against the Fund's limit on lobbying.

Conversely, if PEN publishes a monthly magazine, the Fund may run articles in it and pay the allocable cost of space. However, there would be a risk if, during an election year, PEN publishes editorials featuring its endorsed candidates. While there is no clear authority on whether the Fund could pay for part of the publication, there is significant risk that the IRS would view the use of 501(c)(3) funds to pay for part of a magazine with political content as an impermissible political expenditure.

Example:

PEN wants to run a copy of its partisan voter guide in the Fund's magazine. The Fund should not accept this guide for publication because it could jeopardize its exempt status. If, however, PEN prepares and presents for publication a candidate questionnaire that meets IRS criteria for nonpartisan voter education, the Fund could run this piece.

A 501(c)(3) may, however, sell advertising in its newsletter to any entity, including a candidate. If such ads are available, the 501(c)(3) may sell them to candidates and any other entity but must do so without regard to political preferences and must charge the same fair market value. These advertisements should be identified as "paid advertisements."

If the 501(c)(4) publishes the magazine or newsletter, the same limits do ***not*** apply to the 501(c)(3)'s placing of articles or contributing to the publication. As a 501(c)(4) can do anything that a 501(c)(3) can do without jeopardizing its tax status, the 501(c)(3) may prepare articles and submit them for placement in a 501(c)(4) magazine. The 501(c)(4) has the option of charging fair market value for the article or running it free of cost. Therefore, PEN's magazine may run any piece prepared by the Fund without charging the Fund for placement.

2. Sharing Lists and Databases

If the 501(c)(3) has a contact, email, or membership list, it may rent the list for fair market value in an arm's-length transaction to the 501(c)(4).[16] It is advisable to have a letter of agreement to document the terms of the transaction and the assessed rental value of the list. Alternatively, the groups could exchange names if both organizations have lists, or parts of lists, of equal value. It may also be possible for each group to share the costs of developing a list. In this case, the costs must be divided evenly or in some reasonable manner to avoid the impression that the 501(c)(3) is paying any of the 501(c)(4)'s costs. In this case, each organization would own the list and be able to use it for its programs.

Similar principles should be used in sharing a voter file database or modeling. Many organizations that engage in grassroots organizing and civic engagement use voter files and modeling to identify those people to whom they can most effectively direct their messages and communications. If a 501(c)(3) pays for these resources, it must rent the resources at fair market value to the 501(c)(4). The 501(c)(4) may not be allowed to use the resources at no charge unless the use is limited to charitable or educational purposes in which the 501(c)(3) is permitted to engage. Particular caution should be used if the 501(c)(4) intends to use the database or modeling for partisan political purposes. Organizations should seek guidance before engaging in this type of data transfer or exchange. This type of transaction raises complex issues and there is little guidance available as to its legality.

Example:

If the Fund rents its list to third parties for $75 per thousand names, PEN may rent it at that same rate. The Fund may allow PEN to use the list free of charge if the use is consistent with the exempt purpose of the Fund, that is, its educational purpose. For example, if PEN produces an educational study that does not constitute lobbying, the Fund could contribute its list to PEN in furtherance of this educational activity. The transaction would be an in-kind contribution to PEN.

3. Applying for a Separate Nonprofit Postal Permit

An affiliated 501(c)(4) may not use the postal permit of the 501(c)(3). Each organization must apply for and use its own separate nonprofit postal permit. To apply for a postal permit to mail at the special bulk third-class rates, the organization is required to file Form 3624, "Application to Mail at Special Bulk Third Class Rates." The application is available at post offices and on the Alliance of Nonprofit Mailers' website at www.nonprofitmailers.org. While the organization must pay first-class postage while the application is under review, it may apply for a refund of the difference between the first- and third-class rates if the permit is granted.[17]

4. Joint and Linked Websites

Most related organizations maintain websites that are shared between the 501(c)(3) and 501(c)(4). Otherwise, the two organizations' websites are linked in some manner. In a situation where a 501(c)(3)'s affiliated 501(c)(4) does *not* engage in partisan activity to support or oppose candidates or political parties, a shared website works well. If the 501(c)(4) engages in partisan political activity, the safest strategy is to maintain separate websites, one for each organization. As with other costs discussed above, in either case, each organization must pay its share of the costs of its website or its share of a joint website. It is important for the 501(c)(3) to be able to demonstrate that it is not subsidizing, directly or indirectly, the work of its affiliated 501(c)(4).

501(c)(4) Website. If only the 501(c)(4) maintains a website, it may post content on that website about the programmatic activities or events of any 501(c)(3), including its affiliated 501(c)(3). In that case, the 501(c)(3) may, but is not required to pay the (c)(4) for the cost of posting the material.

Shared Website. If a 501(c)(3) organization owns a website and allows its related 501(c)(4) to post content on the website (or if the two organizations have a joint website), and if the 501(c)(4) conducts political activity, then political material on the website may be attributed to the 501(c)(3), resulting in a violation of the 501(c)(3)'s tax status.

In 2009 the IRS found that a 501(c)(3) organization had engaged in prohibited political activity when its website housed pages for its related 501(c)(4) organization.[18] In that situation the 501(c)(3) organization maintained a website with the 501(c)(4)'s pages nested within that site. The layout and design of all pages on the site were the same. The 501(c)(3) logo appeared on every page of the site; the 501(c)(4) pages *also* bore the logo of the 501(c)(4) organization. Endorsements of political candidates appeared on the 501(c)(4) pages. Despite the fact that the 501(c)(4) paid a proportionate share of the website costs under a cost-sharing agreement between the two organizations, the IRS determined that the 501(c)(3) had engaged in political intervention by hosting the endorsements on its website.

An organization may not use web links in a manner that supports or opposes candidates.

To avoid this pitfall, a joint website maintained by a 501(c)(3) and its affiliated 501(c)(4) must *clearly distinguish* between the content that belongs to the 501(c)(3) and that which belongs to the 501(c)(4). The 501(c)(3)'s banner, logo, address, site links, disclaimer, or similar identifying information specific to the 501(c)(3) should not appear on any of the 501(c)(4) Web pages. Each entity should pay for its proportional costs of the website. It may also be helpful to use a distinct layout and design for the portion of the website devoted to the 501(c)(3) so as to distinguish it noticeably from the portion of the website devoted to the 501(c)(4). Even with these safeguards, however, it is unclear how the IRS would view the shared website.

Links to affiliated and unaffiliated websites. According to the IRS, not only are organizations responsible for the content on their websites, but they are also responsible for their Web links. An organization may not use web links in a manner that supports or opposes candidates. To determine whether a 501(c)(3) is engaging in impermissible political activity by linking from its website to another website, the IRS will look at the context of the sponsoring organization's link.

Only in very narrow situations may a 501(c)(3) link to a website with political content. The facts and circumstances considered by the IRS will include the language that appears on the 501(c)(3)'s website describing the link; whether the 501(c)(3)'s links treat all candidates equally; whether the link serves a proper tax-exempt purpose (such as nonpartisan public education) or, conversely, makes it appear that the organization is supporting an electoral message; and the directness of the links between the organization's website and the Web page containing material supporting or opposing a candidate. The IRS has not said what number of links constitutes sufficient separation, but "electronic proximity—including the number of 'clicks' that separate the objectionable material from the 501(c)(3)'s website—is a significant consideration."[19]

After establishing a link, an organization has an ongoing duty to monitor it. If an organization links to an external website, and if that external website later changes its content so that it becomes political in nature, the 501(c)(3) organization may be held liable for conducting political activity, even though the link was permissible at the time when it was posted.

In a memorandum regarding the 2008 elections, the IRS indicated that it would "not pursue, *at this time*, cases involving a link between a website of a section 501(c)(3) organization and the homepage of a website operated by a related section 501(c)(4) organization."[20] Of course, if the link from the 501(c)(3) website to its related 501(c)(4) includes explicit political language, such as, "Click here to see our endorsed candidates," the IRS might pursue a finding of political intervention by the 501(c)(3) despite the position stated in its 2008 memorandum.

For more information on this issue, *see* Alliance for Justice http://www.afj.org/for-nonprofits-foundations/digital-age.html.

CHAPTER II ENDNOTES

[1] 461 U.S. 540 (1983).

[2] In most cases, an organization will incorporate in the state in which most of its activities take place. However, some organizations choose to incorporate in a different state, which may provide legal advantages related to treatment of nonprofits under state law or the certainty of an established body of state case law concerning corporations. A full discussion of these strategic issues is beyond the scope of this guide. An organization with questions in this area should consult a lawyer for more information.

[3] With some exceptions, 501(c) organizations, depending on their gross receipts, must file one of three forms: 990-N, 990-EZ, or 990.

[4] I.R.C. § 501(c)(3); *Regan v. Taxation with Representation*, 461 U.S. at 544 n. 6; *Center on Corporate Responsibility, Inc. v. Schultz*, 368 F. Supp. 863, 866 n.2 (D.D.C. 1973).

[5] Rev. Rul 81-21; Rev. Rul. 1981-1 CB 482.

[6] *See* 2002 CPE Text, *supra* note 17, at 367.

[7] Treas. Reg. § 53.4942(a)-3.

[8] I.R.C. § 4911.

[9] Treas. Reg. § 56.4911-3(c).

[10] For a discussion of 501(c)(3) limits on lobbying, including the differing definitions and limits for grassroots and direct lobbying, *see Being a Player*, Alliance for Justice.

[11] Treas. Reg. § 56.4911-3(c)(2).

[12] *See* IRS Technical Advice Memorandum 9812001; I.R.C. §§ 4955(a)(1), 4955(a)(2), 527(f).

[13] Treas. Reg. § 1.527-6(b)(1)(ii).

[14] For more information about foundation funding of 501(c)(4)s, *see Myth vs. Fact: Foundation Support of Advocacy* (Alliance for Justice, 1995) and *Investing in Change: A Funder's Guide to Advocacy* (Alliance for Justice, 2004).

[15] *See* 2002 CPE Text *supra* note 20, at 369.

[16] Courts have held that mailing list rental income is royalties, not subject to unrelated business income tax. *See, e.g., Sierra Club v. Commissioner*, 86 F.3d 1526 (9th Cir. 1996).

[17] For more information about nonprofit postal issues, contact the Alliance of Nonprofit Mailers online at http://www.nonprofitmailers.org.

[18] IRS TAM 200908050 (February 20, 2009) available at http://www.irs.gov/pub/irs-wd/0908050.pdf

[19] Memorandum from Lois G. Lerner, Director, IRS Exempt Organizations Division, April 17, 2008, available at http://www.irs.gov/pub/irs-tege/2008_paci_program_letter.pdf at 2.

[20] http://www.irs.gov/pub/irs-tege/internetfielddirective072808.pdf

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