November 16, 2016

The Honorable John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

Re: Comments on Requirement to Provide Notice of Intent to Operate as a Section 501(c)(4) Organization

Dear Commissioner Koskinen:

Enclosed please find comments in response to a Notice of Proposed Rulemaking relating to the requirement to provide notice of an intent to operate as a section 501(c)(4) organization ("Comments"). These Comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss the Comments with you or your staff if that would be helpful.

Sincerely,

[Signature]

William H. Caudill
Chair, Section of Taxation

Enclosure

CCs: William Wilkins, Chief Counsel, Internal Revenue Service
    William M. Paul, Deputy Chief Counsel (Technical), Internal Revenue Service
    Victoria Judson, Associate Chief Counsel (Tax Exempt & Government Entities), Internal Revenue Service
    Sunita Lough, Commissioner (Tax Exempt & Government Entities), Internal Revenue Service
    Tamera Ripperda, Director (Exempt Organizations), Internal Revenue Service
    Chelsea R. Rubin, Office of Associate Chief Counsel (Tax Exempt & Government Entities), Internal Revenue Service
    Mark Mazur, Assistant Secretary (Tax Policy), Department of the Treasury
ABA SECTION OF TAXATION
COMMENTS ON PROPOSED REGULATIONS REGARDING
THE REQUIREMENT TO PROVIDE NOTICE OF AN
INTENT TO OPERATE AS A SECTION 501(c)(4) ORGANIZATION

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Rosemary E. Fei and Elizabeth J. Kingsley of the Exempt Organizations Committee of the Section of Taxation. Substantive contributions were made by Eric K. Gorovitz, Alexander L. Reid, Jennifer I. Reynoso, Wendy Richards, Richard F. Riley, Emily Robertson, B. Holly Schadler, Michael B. Trister, and Maura L. Whelan. These Comments were reviewed by David A. Shevlin, Chair of the Exempt Organizations Committee. The Comments were further reviewed by Robert A. Wexler of the Section’s Committee on Government Submissions, and Kurt L.P. Lawson, Council Director for the Exempt Organizations Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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THE REQUIREMENT TO PROVIDE NOTICE OF AN
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EXECUTIVE SUMMARY

The Protecting Americans for Tax Hikes Act of 2015 (the “PATH Act”),\(^1\) enacted
on December 18, 2015, added section\(^2\) 506. Section 506 requires an organization
described in section 501(c)(4) to notify the Secretary of the Treasury that it intends to
operate as such within 60 days of its establishment.

On July 12, 2016, the Department of the Treasury (the “Treasury”) and the
Internal Revenue Service (the “Service”) issued Proposed Regulations\(^3\) and Final and
Temporary Regulations (together, the “Proposed Regulations”),\(^4\) and Rev. Proc. 2016-41
(the “Revenue Procedure”)\(^5\) to implement this requirement. The Proposed Regulations
generally require notice of an intent to operate as a section 501(c)(4) organization to be
provided by filing Form 8976 (or its successor) with the Service.

These Comments set forth questions, concerns, and suggested revisions to the
procedures and requirements described in or contemplated by the Proposed Regulations
and the Revenue Procedure (together, the “Proposal”).

As noted above, the Proposal consists of the Proposed Regulations and the
Revenue Procedure. We are submitting our comments on the Proposal in a single
document because many of the issues raised herein could reasonably be addressed
through changes to either the Proposed Regulations or to the Revenue Procedure, and in a
number of cases below, we make alternative recommendations involving both
documents.

In these Comments, we recommend:

1. Clarifying the applicability of the transition relief provided in the Proposal to
organizations that filed applications for extensions of time to file their first
Form 990, but not the Form 990 itself, on or before July 8, 2016. (Discussion
Section II.)

2. Expanding the transition relief provided in the Proposal to organizations
formed before the enactment of the PATH Act that complied fully and in good
faith with all filing obligations that existed as of their dates of formation and

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\(^{2}\) References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”) unless otherwise indicated.


\(^{4}\) Temp. Reg. § 1.506-1T.

\(^{5}\) 2016-30 I.R.B. 165.
timely file a Form 990 or, alternatively, automatically extending “reasonable cause” relief to these organizations. (Discussion Section II.)

3. Expanding the transition relief provided in the Proposal to organizations that terminate or dissolve before the applicable Form 8976 due date. (Discussion Section II.)

4. Defining the date that a foreign organization is “established” for purposes of section 506 as the date on which it first commences activities or receives income that would cause it to have a filing requirement under section 6033 or, alternatively, automatically extending “reasonable cause” relief to a foreign organization that files Form 8976 promptly after that date. (Discussion Section III.A.)

5. Automatically extending “reasonable cause” relief to certain very small organizations or, alternatively, expanding the examples provided in the Revenue Procedure to offer more guidance as to what will be deemed “reasonable cause” for their failure to timely file Form 8976. (Discussion Section III.B.)

6. Clarifying the applicability of section 506 to organizations that originally sought, or were granted, exempt status under sections other than section 501(c)(4). (Discussion Section III.C.)

7. Providing that the section 506 notice requirement may be satisfied by filing Form 1024 within the 60-day notice period. (Discussion Section IV.)

8. Providing that the section 506 notice requirement may be satisfied (including for purposes of the transition relief provided by the Proposal) by a central organization if it notifies the Service of a subordinate organization’s intent to operate as a section 501(c)(4) organization by adding it to a group exemption list or filing Form 8976 on its behalf. (Discussion Sections II and V.A.)

9. Confirming that a disregarded entity does not have an independent obligation to file Form 8976. (Discussion Section V.B.)

10. Confirming that any authorized person may submit Form 8976, and a third party submitting the form on behalf of a client only need maintain a written record of its authorization to do so. (Discussion Section VI.)

11. Confirming that there is no duty to amend Form 8976 when the information originally reported on it changes, clarifying whether there is a duty to amend the form if the information originally reported on it was missing or erroneous, and in either case clarifying the process for making changes or corrections. (Discussion Section VI.)
DISCUSSION

I. Public Inspection

Before turning to specific technical comments, we would like to note that we agree with the Proposal’s conclusion that notices filed under section 506 will not be open for public inspection, on the basis that they are not applications within the meaning of section 6104, even though arguably this is at odds with the view implicit in the Joint Committee on Taxation’s Technical Explanation of the PATH Act⁶ and with the transparency goals that we believe motivated, at least in part, the enactment of section 506. The notices to be filed under section 506 clearly are distinct from applications for recognition of exemption. Public access to the notices would appear to require a specific reference in section 6104(a)(1)(A) to notices filed under section 506 (similar to the reference in that section to the notices of status to be filed under section 527(i) for organizations exempt under section 527, which are open to public inspection).

II. Transition Issues

Under the PATH Act, the notice requirement does not apply to section 501(c)(4) organizations that notified the Service of their existence before December 18, 2015. Under the Proposal, section 501(c)(4) organizations that notified the Service of their existence before July 8, 2015, also are not required to submit a completed Form 8976. The Proposal extends the filing deadline for Form 8976 applicable to other organizations to September 6, 2016.

We are pleased that the Proposal opts not to require the filing of Form 8976 by organizations that are covered by the statute (i.e., those created after December 18, 2015, and those that were in existence but had not filed Form 1024 or Form 990 on that date), but that filed either Form 1024 or Form 990 on or before July 8, 2016. Asking such an organization to provide notice of its intent to operate as a section 501(c)(4) organization would serve no purpose, as it effectively has provided the Service with that notice by filing Form 1024 or Form 990.

We believe it would be helpful to clarify that this treatment also applies to an organization that is included in a group Form 990 that is filed on or before July 8, 2016, as such a filing also effectively provides the Service with notice of the organization’s intent to operate as a section 501(c)(4) organization.

We also believe it would be helpful to clarify that this treatment does not apply to an organization covered by the statute that filed only an application for an extension of time to file its first Form 990 on or before July 8, 2016, and not the Form 990 itself. That is because filing an application for an extension does not indicate the Code section under

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⁶ See Staff of the J. Comm. Tax’n, 114th Cong., Technical Explanation of the Revenue Provisions of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40), 240 (Comm. Print 2015) (JCX-144-15), which states that “[t]he notice and receipt are subject to the disclosure requirements of section 6104.”
which an organization claims exemption, and therefore does not effectively provide the Service with the required notice.

We also recommend that additional transition relief be extended to any organization that complied fully and in good faith with all filing obligations with the Service that existed as of its date of formation before enactment of the PATH Act, but that failed to file a Form 1024 or Form 990 by July 8, 2016, provided that it does file a timely Form 990 thereafter. Our main reason for making this recommendation is that many organizations that are just starting up, especially smaller ones without legal counsel, do their due diligence on the exemption process at the time of their formation. Consequently, despite good faith efforts at compliance, they might not learn of any new rules that are imposed after that date until it is too late to comply with them. For example, an organization formed in October 2015 (before section 506 existed) with a tax year ending September 30 could, with proper extensions, timely file its first Form 990 in August 2017. It would be exposed to significant penalties for failing to file the section 506 notice even though the only way it could have known of this obligation would have been to monitor continuously for legislative changes—not something a typical start-up has the time or resources to do. We believe this will affect only a small number of organizations. If this recommendation is not adopted, we suggest that automatic “reasonable cause” relief be extended to such organizations.

We also recommend that an organization that is covered by the statute but that terminated or dissolved before September 6, 2016 (i.e., the extended deadline for filing the Form 8976) be exempt from the filing obligation. We believe that it would serve little purpose for such an organization to file a notice, and that the organization is unlikely to have terminated or dissolved to avoid the notice requirement. However, we do not suggest extending this relief to future periods. We believe that doing so could create an incentive for “pop-up” organizations that claim exemption under section 501(c)(4) in order to engage primarily in political advocacy. If these groups were not required to file Form 8976 within 60 days of their formation, the first notice the Service would have of their existence would be when their initial—and simultaneously final—Form 990 was filed, potentially nearly a year after they had closed their doors and ceased operations. This seems contrary to the transparency goals we believe underlie the statute.

While these comments are being submitted after the September 6, 2016, filing deadline, we nonetheless believe it would be beneficial to provide guidance in some form on the transition issues discussed above. Questions will no doubt arise in the future for organizations that had filed only applications for extensions of time to file Form 990, or that had dissolved before the initial filing deadline. A clear statement regarding the applicability of the filing requirement to these groups, or a discussion of whether they might be eligible for “reasonable cause” relief, would help resolve such questions fairly, consistently, and expeditiously.

III. “Reasonable Cause” for Failure to File

The PATH Act also amended section 6652(c) to impose penalties for failing to comply with the notice requirement under section 506. The penalties generally are $20
per day for each day the failure continues, up to a maximum of $5,000. However, relief
from these penalties may be obtained where an organization establishes to the satisfaction
of the Service that the failure was due to “reasonable cause.” The Revenue Procedure
includes one example of “reasonable cause” for this purpose.

A. Foreign Organizations

The preamble to the Proposed Regulations\textsuperscript{7} indicates that a foreign organization
that has operated outside the U.S. before commencing operations within the U.S. as a
section 501(c)(4) organization may have “reasonable cause,” and therefore be eligible for
relief from penalties, if it submits the notice promptly after it first commences activities
within the U.S. or receives income that would cause it to have a filing requirement under
section 6033. The Revenue Procedure addresses this situation as an example (indeed, the
only example) of when an organization’s failure to file Form 8976 within 60 days of
formation was for “reasonable cause.”

We recommend that, instead of handling this situation under the “reasonable
cause” rule, the date that the foreign organization is “established” for purposes of section
506 be defined as the date on which it first commences activities or receives income that
would cause it to have a filing requirement under section 6033. Our main reason for
making this recommendation is that handling this situation under the “reasonable cause”
rule seems likely to result in the automatic generation of numerous unnecessary penalty
notices. While most, if not all, of the penalties will eventually be waived, in the
meantime they will impose administrative burdens and create confusion for their
recipients, especially smaller organizations that lack sophisticated counsel.\textsuperscript{8}

Alternatively, if this recommendation is not adopted, we suggest that the online
Form 8976 ask whether the filer is created under the laws of a foreign jurisdiction, and, if
so, the date on which it first commenced U.S. activities. Gathering this information
would allow the Service to extend “reasonable cause” relief automatically to
organizations that have filed promptly. In any event, we urge the Service to ensure that
the notices that it sends to taxpayers of proposed penalties under section 6652(c) include
information about the availability of “reasonable cause” relief in this situation and
explicitly mention the Revenue Procedure and the example.

More generally, we recommend that the Treasury and the Service revisit the
annual return filing obligations of foreign tax-exempt organizations in the U.S. In our
experience, there continues to be a great deal of uncertainty regarding these obligations,

\textsuperscript{7}See 81 Fed. Reg. 45008, 45010 (July 12, 2016).

\textsuperscript{8}The use of a set date for when the organization is “established” also would aid in avoiding the adverse
inference of having failed to register previously and the attendant consequences. For example, when a U.S.
organization makes a grant to a non-U.S. organization, a common question is whether the grant is subject to
withholding tax for payments by a U.S. organization to a foreign organization. In order for the grantee to
indicate that it is exempt from withholding tax, it must obtain an opinion of counsel that it is equivalent to a
U.S. tax-exempt organization exempt under section 501(a). It is common to opine that the foreign grantee
is equivalent to a section 501(c)(4) organization. Use of a date certain would provide much clearer
guidance to foreign organizations as to their filing obligations on Form8976.
and we believe that the application of section 506 to foreign organizations will compound this problem.

B. Small Organizations

We recommend that small organizations be provided with “reasonable cause” relief that is similar to the relief provided under Rev. Proc. 2014-11, which excuses certain organizations eligible to file a Form 990-N or Form 990-EZ from having to demonstrate “reasonable cause” under section 6033(j)(3) for not filing information returns. While the consequences of failing to comply with the notice requirement under section 506 are not as severe as revocation of an organization's exemption under section 6033(j)(1) for not filing information returns, the financial burden on a small organization could be significant. The types of organizations that qualify under section 501(c)(4) include a variety of community and youth-focused organizations that frequently are run solely by volunteer leaders. Often, these organizations have little to no initial contact with professionals that can help them understand these requirements. The fact that notice under section 506 is required very shortly after they are created further increases the likelihood of noncompliance. Such organizations are likely to be noncompliant due to ignorance, are less likely to be able to afford professional assistance to argue for “reasonable cause,” and could be significantly disadvantaged by penalties imposed under section 6652(c).

We are concerned that not providing additional “reasonable cause” relief to organizations that are eligible for streamlined retroactive reinstatement under Rev. Proc. 2014-11 could create a significant disincentive for them to come into compliance and “clean up” previous years’ failures to file. The reality is that there are significant numbers of very small social welfare organizations that are active but have never filed a Form 1023 or 1024, or a Form 990-N or 990-EZ, whose exemptions have been revoked automatically by operation of law (though this may not have been officially announced yet, and the organization may be unaware), and that therefore are eligible for retroactive reinstatement. Before section 506, those organizations could, with relatively little cost or penalty beyond filing a Form 1024, obtain reinstatement of their tax-exempt status for prior years in which they operated as a self-declared section 501(c)(4) organization. Allowing them to be reinstated relatively easily is beneficial to the entire tax system because the unrealistic alternative would be to require organizations that improve social welfare yet have few resources and little practical tax liability to address prior years where they would be treated as taxable corporations. We believe that the potential penalties on the organizations and their management under section 6652(c) are likely to discourage them from coming forward and becoming compliant unless there is guidance reconciling Rev. Proc. 2014-11 with the new section 506 notice requirement and providing that the penalties will be abated in many such circumstances for “reasonable cause.”

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9 The situation described in the main text is distinguishable from that of an organization incorporated years in the past intending to operate as a section 501(c)(4) organization that never filed a Form 1024 and that has
If this recommendation is not adopted, we suggest that the Service expand the example provided in the Revenue Procedure, and offer more guidance as to what will be deemed “reasonable cause” – a phrase which in our experience has been interpreted quite differently in different settings even within the context of exempt organizations. If this approach is taken, we suggest including a non-exhaustive list of factors that will weigh in favor of a finding of “reasonable cause,” including that an organization is small and/or volunteer-run, that it cannot afford outside legal or accounting advice, or that it relied on faulty accounting or legal advice.

C. Organizations Exempt Under Sections Other Than Section 501(c)(4)

We recommend that automatic “reasonable cause” relief be extended to (1) organizations filing Form 1023 more than 27 months from the dates they were formed, provided there is no evidence that they failed to operate in compliance with the requirements of section 501(c)(3) before filing Form 1023, and (2) organizations that apply for exemption under section 501(c)(3) in good faith but later self-declare under section 501(c)(4) (or apply on Form 1024 for recognition of exempt status under section 501(c)(4)). We believe that these changes would simplify the “reasonable cause” determination without creating significant compliance issues. An organization eligible for exemption under section 501(c)(3) that files Form 1023 more than 27 months from the date it was formed must complete Form 990, Schedule E, which is used to determine whether it is eligible to be treated as a section 501(c)(3) organization from its date of formation, or, if not, whether it is eligible for exemption under section 501(c)(4) for the period between the date of formation and the postmark date of its application. Similarly, an organization that files Form 1023 for recognition of exempt status under section 501(c)(3) may, after an initial review and discussion with the Service, decide to self-declare under section 501(c)(4) (or apply on Form 1024 for recognition of exempt status under section 501(c)(4)). Having to make individual “reasonable cause” determinations will impose burdens on these organizations, which presumably will not have filed Form 8976 by the 60-day deadline because they always intended to qualify for exemption under section 501(c)(3) rather than section 501(c)(4), and on the Service, even though the outcome in many cases will be the same (i.e., the grant of a waiver).

If this recommendation is adopted, we suggest that a similar approach be taken to organizations that properly change their exempt status, or initially are reasonably mistaken about what type of exempt status for which they qualify. Like the organizations described above, we believe that such an organization should be eligible for waiver of penalties if it files Form 8976 within 60 days of becoming or learning it is a section 501(c)(4) organization. For example, not infrequently an entity is organized with the intent of qualifying under section 501(c)(4) but, because it failed to file any Forms 990, and that either never operated at all, or has ceased to operate. Because it never registered with the Service as a section 501(c)(4) organization, it would not have received notice that its exemption was automatically revoked, but as a matter of fact it would have been revoked by operation of law. Such an organization is no longer exempt under section 501(c)(4) due to the automatic revocation, but also no longer qualifies for section 501(c)(4) exempt status due to the absence of any activities, including any social welfare activities; retroactive reinstatement is not available to it. It should not need to file Form 8976, and it should not be subject to any penalties under section 506 in any event. If the organization is dormant, it should be able to dissolve quietly under state law without federal tax penalty.
bona fide intent to qualify for exemption under section 501(c)(5) or section 501(c)(6), but later decides that section 501(c)(4) is a better fit. This may occur where the organization’s mission has evolved, or because it applied for exemption under a different section and was denied by the Service. If this change of status is accomplished by amending the organization’s governing documents (such as re-framing the corporate purpose), we presume that the obligation to file Form 8976 would be triggered on the date of amendment. This could be made clear in the definition of “the date the organization is organized” in the Proposed Regulations. Other trigger dates would need to be specified where no amendment of the governing documents was required to change exempt status.

Alternatively, if this recommendation is not adopted, we suggest adding examples indicating that organizations in these situations ordinarily will be eligible for “reasonable cause” relief.

IV. Option to File Form 1024 or Form 990 in Lieu of Notice

As noted above, we are pleased that the Proposal opts not to require the filing of Form 8976 by organizations that are covered by the statute but have filed either Form 1024 or Form 990 on or before July 8, 2016. Consistent with this, we recommend that an organization always be treated as satisfying the notice requirement under section 506 if it files a Form 1024, rather than Form 8976, within the 60-day notice period. Simply put, filing Form 8976 seems to us to be duplicative and a waste of resources – particularly for the small organizations that are likely to make up the bulk of the filers – where the organization already has notified the Service that it is claiming section 501(c)(4) status before the end of the notice period.

V. Applicability of the Form 8976 Filing Obligation for Special Organizations

A. Group Exemptions

Consistent with our recommendation in Section II above, we recommend that if a central organization notifies the Service of a subordinate organization’s intention to operate as a section 501(c)(4) organization by either adding it to the group exemption list or filing Form 8976 on behalf of the new section 501(c)(4) organization on a group basis within the required 60-day period, then such action by the central organization should be treated as satisfying the notice requirement under section 506 for the subordinate organization. Organizations holding section 501(c)(4) group rulings may add newly formed organizations to the group ruling as frequently as monthly. If the group ruling holder notifies the Service of the new organization’s formation (of files Form 8976 on its behalf) within the requisite 60-day period, we believe this should suffice for purposes of section 506.

B. Single-Member LLCs

We assume that, consistent with other exempt organization guidance, a single-member limited liability company whose sole member is a section 501(c)(4) organization and which does not opt for separate taxation from its member but rather is disregarded,
will not have an independent obligation to file Form 8976. However, confirmation of this view would be welcome.

VI. Practical Logistics of Filing Form 8976

We suggest that final guidance clarify that Form 8976 may be submitted by anyone that a Section 501(c)(4) organization authorizes to do so (and that maintains a written record of that authorization), and specifically that the form does not have to be submitted by an officer or a person holding a power of attorney on file with the Service on Form 2848. Many newly-created organizations look to their attorneys or accountants to file similar routine, basic paperwork on their behalf, and we see no need to require more in this situation. Nothing in the Proposal suggests the contrary, but confirmation of this view would be welcome.

We also suggest that final guidance clarify that a section 501(c)(4) organization has no duty to update Form 8976 if any of the information provided, such as its address or accounting period, was correct on the original form but later changes. We also suggest that final guidance clarify whether a section 501(c)(4) organization has a duty to update Form 8976 if any of the information provided was incorrect on the original form. If either duty exists, we request that a mechanism be provided for making the changes or corrections.

CONCLUSION

We appreciate the opportunity to comment on the Proposal.