

Section of Taxation

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November 21, 2017

The Honorable David Kautter
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024

Re: Comments Concerning Form 1024-A, Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code

Dear Acting Commissioner Kautter:

Pursuant to our letter of October 11, 2017, concerning the comment period for this matter (82 FR 40228 (2017)), enclosed please find comments concerning Form 1024-A, Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code ("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 will be pleased to discuss the Comments with you or your staff if that would be helpful.

Sincerely,



Karen L. Hawkins
Chair, Section of Taxation

Enclosure

cc: Sunita B. Lough, Commissioner, Tax Exempt & Government Entities Division,
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**AMERICAN BAR ASSOCIATION
SECTION OF TAXATION
COMMENTS ON DRAFT FORM 1024-A, APPLICATION FOR
RECOGNITION OF EXEMPTION UNDER SECTION 501(c)(4) OF THE
INTERNAL REVENUE CODE**

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 Elizabeth J. Kingsley, John Pomeranz, and Richard F. Riley Jr. of the Exempt Organizations Committee of the Section of Taxation. Substantive contributions were made by Eve Borenstein and Emily Robertson. These Comments were reviewed by Lisa L. Johnsen and Rosemary Fei, Chair and Vice Chair, respectively, of the Exempt Organizations Committee. The Comments were further reviewed by Julian Y. Kim, the Section’s Vice-Chair, Government Relations.

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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Date: November 21, 2017

EXECUTIVE SUMMARY

On August 24, 2017, the Department of the Treasury (the “Treasury”) and the Internal Revenue Service (the “Service”) requested comments regarding draft Form 1024-A, Application for Recognition of Exemption Under section 501(c)(4) of the Internal Revenue Code (“Form 1024-A”).¹

We appreciate that the Service extended the originally announced comment period to allow sixty days from the September 28, 2017 date on which the draft Form 1024-A became available for review.²

The Protecting Americans from Tax Hikes Act of 2015³ created a new registration requirement for section 501(c)(4)⁴ organizations and provided a separate mechanism for use by organizations applying for a determination of their section 501(c)(4) status. In explaining the provision, the Joint Committee on Taxation stated that “[i]t is intended that such a request for a determination be submitted on a new form (separate from Form 1024, which may continue to be used by certain other organizations) that clearly states that filing such a request is optional.”⁵ The draft form will accomplish this stated intent.

It is not clear what lawmakers sought to achieve with a different section 501(c)(4) exemption application separate from the existing Form 1024. One advantage is that Form 1024-A simplifies the application by removing those portions of Form 1024 not relevant to organizations seeking exemption under section 501(c)(4) while collecting the information necessary for the Service to make a determination of section 501(c)(4) status.

In reviewing and commenting on the draft form, we have been guided by this presumed goal of simplifying the process for organizations seeking a section 501(c)(4) determination. At the same time, the form should collect all the information reasonably necessary for the Service to determine that the organization does, in fact, meet the requirements of section 501(c)(4).⁶ To the degree possible, we recommend that the categories of information requested on Form 1024-A be consistent with the categories used in subsequent Form 990 returns, in the organization’s financial records, and in the records of related section 501(c)(3) or other 501(c) organizations.

¹ 82 Fed. Reg. 40228 (Aug. 24, 2017).

² 82 Fed. Reg. 48746 (Oct. 19, 2017).

³ PATH Act, Pub. L. No. 114-113, 129 Stat. 2242.

⁴ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

⁵ JT. COMM. ON TAX’N, TECH. EXPLANATION OF THE PROTECTING AMERICANS FROM TAX HIKES ACT OF 2015 at 241 (JCX-144-15, Dec. 17, 2015).

⁶ At least one commentator has raised the question of whether section 501(c)(4) exemption should be granted on the basis of a much simpler form akin to the Form 1023-EZ that is now available for certain organizations exempt under section 501(c)(3) of the Code. *See*, Barnaby Zall, “New IRS Form 1024-A for new 501(c)(4)s,” available online at <https://publicpolicylegal.com/2017/09/28/new-irs-form-1024-a-for-new-501c4s/>. In preparing these comments we considered this suggestion but ultimately did not adopt it. Unlike section 501(c)(3) organizations, section 501(c)(4) organizations seeking tax-exempt status are free to self-declare their tax-exempt status and avoid the burdens of filing an application for recognition of that status. For those organizations that do desire a determination of their section 501(c)(4) status, it is appropriate for the Service to do a review sufficient to determine that the organization meets the requirements for exemption under section 501(c)(4).

In general, draft Form 1024-A appears designed to capture the basic information necessary to make a determination of section 501(c)(4) status, without requests for irrelevant information. Compared to the current Form 1024 and Form 1023 applications, the questions in the Form 1024-A are phrased in a more practical, less technical fashion, which we believe is a good approach. Directing applicants in a number of the questions to include an attachment with additional information, without requiring a specific schedule, is also practical. After a few years of receiving Form 1024-A applications, we recommend that the Service evaluate whether these applicant-created attachments are providing the necessary information and whether similarities in these additional responses might suggest additions or revisions to the questions on the form itself.

In several places, we suggest that the form instructions elaborate on the information sought, or the purpose for requesting the information, to help ensure more accurate and responsive information. Although we might wish that all applicants carefully read the more detailed instructions that explain the information requested on each line, the reality is that some will give the instructions a mere cursory review, especially when the terms used on the form itself seem self-explanatory. In-form prompts will improve the quality of the applications received.⁷

More specifically, and as explained in more detail below, we make the following recommendations:

Form Part and Line	Recommendation
Caption	Make notice of the optional nature of application more prominent
Part II, Heading	Avoid describing limited liability companies as corporations
Part IV, Line 1	Expand the list of individuals and entities to be reported
Part IV, Line 3a	Improve the wording of the question on compensation paid
Part IV, Line 3b	Require attachment of a conflict-of-interest policy
Part V, Line 1	Clarify the information sought on political activities and the reason for seeking it
Part V, Line 2	Warn applicants of the limits on section 501(c)(4) eligibility for organizations that have previously lost section 501(c)(3) status for excessive lobbying or electioneering
Part V, Line 4	Clarify the information sought on relationships with other entities
Part V, Line 7	Ask about payments for goods as well as services
Part V, Line 9	Request the information necessary to determine whether a homeowner's association is exempt under section 501(c)(4)
Part V, Line 10	Request the information necessary to determine whether a local association of employees is exempt under section 501(c)(4)

⁷ We note that the Service at one time was about to make available an electronic exemption application that offered embedded tips for completing the form, as well as error checking and other features. This project was cancelled for lack of resources and other reasons, but the Service might want to consider another attempt at such an application in the future.

Part V, Line 11	Anticipate the information needed to determine foreign activity compliance with Office of Foreign Asset Control and anti-terrorism requirements and request that information
Part V, New Question	Add an additional question in Part V to collect information about social activities
Part VI.A	Align the Statement of Revenue (Part VI.A.) with the categories of revenue used on Part I of the Form 990 or, as an alternative, add clarification regarding reporting of revenue from membership dues

Finally, we note that some of these comments apply not only to the proposed Form 1024-A, but to the existing Forms 1023 and 1024. When resources permit the Service to revisit these forms, we hope that the Service will consider some of the comments here as applicable. We look forward to commenting on those new forms at that time.

DISCUSSION

Caption: In calling for a form other than the existing Form 1024 for section 501(c)(4) organizations seeking recognition of their tax-exempt status, the Joint Committee on Taxation urged that such a form "clearly state[] that filing such a request is optional."⁸ In light of the importance the Committee placed on this point, we suggest that the sentence in the caption on the draft form "A request for determination under section 501(c)(4) is optional" be made more prominent by placing it in bold, underlined, or italicized text, setting it apart from the surrounding text, or some combination thereof.

Part II, Heading: Limited liability companies are not a form of corporation or incorporated under state corporation laws, so including limited liability companies in the term "corporation" is confusing. We suggest the parenthetical in this be replaced by ", a limited liability company".

Part IV, Line 1: In order to identify individuals who are leaders of the organization as well as potential "insiders" for purposes of assessing private inurement and excess benefit, we suggest that this list include not only "officers, directors, and trustees" but also "key employees and other highly compensated employees and independent contractors." Adding key employees and contractors to this list will require that the caption of the second column be changed from "Title" to "Title or services provided."

We also suggest including an in-form explanation. While terms such as "officers" and "highly compensated employees" should be appropriately defined in the instructions, we suggest that the form itself include the parenthetical: "(i.e., the people who govern or manage the organization and the people or companies highly paid by the organization)."

Thus, Line 1 would read: "List the names, title, and mailing addresses for all your officers, directors, trustees, key employees, and other highly compensated employees and

⁸ JCX-144-15, *supra* note 3, at 241.

independent contractors (i.e., the people who govern or manage the organization and the people or companies highly paid by the organization)."

Part IV, Line 3a: Any employees or independent contractors, by definition, will be compensated. Further, it is potentially burdensome and largely irrelevant to section 501(c)(4) qualification to require compensation information about all employees. Therefore, we suggest changing the question to read: "Do or will you pay any compensation to any individual or company identified in Part IV, Line 1, or to any of your members? If 'Yes,' answer lines 3b and 3c."

Part IV, Line 3b: This question should include after the first sentence: "If 'Yes,' attach a copy of the conflict of interest policy adopted by the organization." In our experience, the conflict of interest policy disclosure obligation in Form 1023 has had the salutary effect of encouraging adoption of such policies in the charitable sector.

Part V, Line 1: Political campaign activities by section 501(c)(4) social welfare organizations have been the main source of controversy for such organizations in recent years, and are likely a key reason for the passage of section 501(c)(4)-related provisions in the PATH Act and, thus, the separate Form 1024-A application. On balance, this question about political campaign expenditures seems well-phrased and should elicit the necessary information for determination of tax-exempt status under section 501(c)(4). To be clearer about the information needed and the rationale behind requesting it, however, we suggest that the last sentence of this question be replaced with: "If 'Yes,' explain in detail the organization's activities and expenditures in this area, and list the amounts spent or to be spent in each case in an attachment. (Note that section 501(c)(4) organizations must be primarily engaged in social welfare activities, and the organization's political activities are not considered social welfare activities.)"

Part V, Line 2: Almost all organizations that answer "Yes" to this question are barred by statute from exemption under section 501(c)(4).⁹ It would be helpful to make applicants aware of that fact in the form itself. In addition, the phrasing of the question could be improved by amending it to read: "Have you (or any predecessor organization) previously received a ruling recognizing you (or such predecessor organization) as exempt under section 501(c)(3) and then had such ruling later revoked due to carrying on propaganda or otherwise attempting to influence legislation or due to engaging in political activity? If 'Yes,' you only qualify for exemption under section 501(c)(4) if you were, or your predecessor was, a church. Explain in an attachment."

Part V, Line 4: In the first line, the word "organization" should be "organization or company" to assure inclusion of both nonprofit and for-profit connected entities. In addition, in the parenthetical phrase, add as one of the examples: "an organization or company is your parent or subsidiary."

Part V, Line 7: We suggest that the question be broadened to include payments for goods as well as services by amending the beginning of the question to read: "Do you receive payments for goods provided or services performed? If 'Yes,' explain in an attachment the goods sold or services performed, income realized..."

⁹ I.R.C. § 504.

Part V, Line 9: To collect the necessary information to determine whether the homeowner's association meets the requirements for section 501(c)(4) status, add at the end of the existing last sentence: "and describe in the attachment how your activities promote the social welfare of the community, rather than the private interest of your members."

Part V, Line 10: To collect the necessary information to determine whether the local association of employees meets the requirements for section 501(c)(4) status, add at the end of the existing last sentence: "and describe in the attachment how you will ensure that your net earnings are devoted exclusively to charitable, educational, or recreational purposes."

Part V, Line 11: Practitioners' recent experience with the questions in Form 1023 that ask about foreign and international activities of the applicant organization is that a "Yes" answer almost always generates follow-up questions about how the organization intends to comply with foreign asset control and anti-terrorism requirements and best practices. If the Service expects that such follow-up questions will be the practice for applicants answering "Yes" to this question, then the question should specifically direct the applicant to include that type of information in the attachment to avoid further inquiries if possible. If there is not room on the form for this level of detail, the question could direct applicants to see the instructions for what to include on an attachment.

Part V, proposed additional question: One common problem for prospective section 501(c)(4) organizations is that they support too many purely social activities to be "primarily" engaged in social welfare activities.¹⁰ To collect information helpful in determining whether the organization is primarily engaged in social welfare activity, we recommend adding an additional question: "Will you engage in or provide support for social or recreational activities for the enjoyment of your member or others? If 'Yes,' describe in an attachment the social or recreational activities and the percentage of time and funds spent on such activities."

Part VI.A. (Statement of Revenues and Expenses): In general, the categories of revenue requested align with those required on the Form 1023 (with a few changes that appear to be based on space limitations). This is an improvement over the revenue and expense categories on the current Form 1024, which are tagged with misleading labels that can only be properly understood by careful reading of the instructions.¹¹ As noted above, uniformity with the Form 1023 can also help to lessen possible confusion and ease administrative burdens in the common situation where a section 501(c)(4) organization is related to or operated in connection with a section 501(c)(3) organization that shares a similar mission.

¹⁰ See, e.g., *Audit Technique Guide – IRC Section 501(c)(4), Civic Leagues, Social Welfare Organizations, and Local Associations of Employees*, available online at https://www.irs.gov/pub/irs-tege/atg_501c4_orgs.pdf.

¹¹ As an example, a casual reader would likely assume that when Line 9 of Form 1024 asks for "expenses attributable to activities related to the organization's exempt purposes," they should include most of the organization's expenses, other than those specifically itemized in other lines. The instructions, however, indicate that this line should include only those expenses directly related to income reported on Line 3, "Gross amounts derived from activities related to the organization's exempt purpose." Expenses that further the mission in ways that do not generate revenue are to be included on other lines.

That said, there are circumstances where uniformity between the section 501(c)(3) and section 501(c)(4) applications should be a secondary consideration. The draft form uses revenue categories that parallel those used on the Form 1023 and for calculating section 501(c)(3) public support on Form 990, Schedule A. These categories derive from classifications of revenue used to calculate public support for a section 501(c)(3) entity and are not categories that would necessarily be intuitive or meaningful for a section 501(c)(4) organization. Moreover, they are not likely to generate information useful in determining section 501(c)(4) qualification. Public support is only potentially relevant in the rare case that a section 509(a)(3) supporting organization supports a non-section 501(c)(3) supported organization, which must nonetheless qualify as publicly supported under section 509(a)(2). Even in that case, this form would not show enough information to be able to assess public support as it covers only three years and does not inquire about amounts received from substantial contributors. It is of little value to force all applicants for section 501(c)(4) status to present their revenue information in this format.

Instead, we recommend that the Service make every effort to minimize the reporting burden on applicants by aligning the categories of information requested on the Form 1024-A with those that are otherwise applicable to a section 501(c)(4) organization. Most applicant organizations will be asked to report their revenue on Form 990 in the categories listed in Part I of that form: contributions and grants, program service revenue, investment income, and other revenue. The Service has already determined that receiving revenue information in these categories is sufficient for ongoing monitoring of section 501(c)(4) qualification. We suggest that the same presentation should be sufficient to aid in determining section 501(c)(4) qualification in the first place. If additional detail is required for “other revenue,” that could be derived from Part VIII of Form 990.

If this suggestion is not acceptable, we recommend that some clarifying language be added with respect to membership fees. Some portion of membership dues may be reportable on Line 9 as gross receipts from an activity related to the organization’s exempt purpose, but a casual reader would not discern this. Accuracy could be improved by adding to Line 2 “(including dues) that are equivalent to gifts,” and to Line 9 “other than membership dues reported on Line 2.” Without such clarification on the face of the form, it is unlikely that these revenue lines will be properly completed or, indeed, helpful to the Service in making a determination.