



Rules of conduct of 501 (c) 4 Organizations Activities that Jeopardize Exemption

Civic leagues and social welfare organizations are exempt under section 501 (c)(4) of the Internal Revenue Code. Social welfare organizations generally fall into one of the following categories:

- Organizations that may be performing some type of public or community benefit but whose principal feature is lack of private benefit or profit;
- Organizations that would qualify for exemption under section 501(c)(3) but for a defect in their organizing documents or if they were not “action organizations”; and
- Nonprofit organizations that traditionally have been labeled in common parlance as social welfare organizations.
- During its existence, a social welfare organization has numerous interactions with the IRS- from filing an application for recognition of tax-exempt status, to filing the required annual information returns, to making changes in its mission and purpose. This article focuses on the topic below:

Life Cycle of a Social Welfare Organization- Jeopardizing Exemption

A social welfare organization will jeopardize its exemption under Code section 501 (c)(4) if it ceases to operate primarily to further social welfare purposes. Activities that do not further social welfare purposes, and thus may jeopardize an organization’s tax-exempt status if they become the organization’s primary activities, include:

- I. Social activity and social welfare
- II. Political activity
- III. Increment of net earnings
- IV. Operation for the benefit of private individuals
- V. Business activity (including providing commercial-type insurance)

I. Social activity and social welfare

If social activities will be an organization’s primary purpose, it will not qualify for exemption as a social welfare organization under section 501 (c)(4). It may, however, qualify as a social club described in section 501 (c)(7). To be exempt under Internal Revenue Code section 501 (c)(7), a social club must be organized for pleasure, recreation, and other similar non-profitable purposes and substantially all of its activities must be for these purposes. A club will not be recognized as tax exempt if its charter, by laws, or other governing instrument, or any written policy statement provides for discrimination against any person based on race, color, or religion. There is an exception, however, for a club that in good faith limits its membership to members of a particular religion, to further the teaching or principles of that religion and not to exclude individuals of a particular race or color.

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II. Political Activity and Social Welfare

Promoting social welfare does not include direct or indirect participation or intervention in political campaigns or behalf of or in opposition to any candidate for public office. However, if an organization is organized exclusively to promote social welfare, it may still obtain exemption even if it participates legally

in some political activity on behalf of or in opposition to candidates for public office. Political activities may not be the organization's primary activities, however.

III. Inurement of Net Earnings

Section 501 (c)® of the Internal Revenue Code expressly prohibits inurement of the net earnings of an entity otherwise described in that paragraph to the benefit of any private shareholder or individual.

Moreover, the Code imposes excise taxes on excess benefit transactions between a disqualified person and any organization described in section 501 (c)(4). The regulations provide that an organization is described in section 501 (c)(4) if:

- It has applied for and received recognition from the Service as an organization described in section 501 (c)(4); or
- It has filed an application for recognition of exemption under section 501 (c)(4), filed an annual return as a section 501 (c)(4) organization, or has otherwise held itself out as an organization described in that section.

IV. Operating for Private Benefit

An organization that primarily benefits private individuals is not exempt under Code section 501 (c)(4). For example, an organization that restricts the use of its facilities to employees of selected corporations and their guests is primarily benefiting a private group rather than the community and is not exempt. Similarly, an organization formed to represent member-tenants of an apartment complex does not qualify, because its activities benefit the member-tenants and not all tenants in the community. However, an organization formed to promote the legal rights of all tenants in a particular community may qualify under section 501 (c)(4) as a social welfare organization.

Similarly, an organization that provides retirement benefits to members does not qualify for exemption as a social welfare organization.

V. Business Activities and Social Welfare

An organization does not operate primarily to promote social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations operated for profit. Thus, for example, a nonprofit corporation that operates a semiprofessional baseball club as its principal activity is not entitled to exemption under section 501 (c)(4).

VI. Gaming Activities and Social Welfare

A nonprofit organization that conducts weekly drawing among members of the general public as its principal activity and uses the profits primarily to pay its general expenses is not exempt. (Revenue Ruling 61-158m 1961-2 C.B, 115). On the other hand, that an organization's principal source of income is from gaming activities does not preclude exemption. In reaching this conclusion. Revenue Ruling 68-45, 1968-1 C.B. 259 reasoned:



“The fact that the organization’s principal source of income is from the conduct of bingo games with the general public does not mean that the games are also its primary activity. All the facts and circumstances are taken into account in determining an organization’s primary activity and the facts in this case clearly establish that the organization’s social welfare activities are its primary activities.”

If you would like additional information about this new filing requirement or information about other new developments, subscribe to Exempt Organization’s contact MillerMusmar CPAs main office in Reston Virginia at 703-437-8877 or Manassas at 703-365-8877.

Please be advised that, based on current IRS rules and standards, the advice contained herein is not intended or written by the practitioner to be used and cannot be used by the taxpayer for the purpose of avoiding penalties.

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