

# **Audit Technique Guide – IRC Section 501(c)(4), Civic Leagues, Social Welfare Organizations, and Local Associations of Employees**

## **Introduction**

This guide provides guidelines for the audits of Civic Leagues, Social Welfare Organizations and Local Associations of Employees exempt under IRC Section 501(c)(4) of the Internal Revenue Code. It's not all-inclusive or intended to restrict auditors in identifying issues or using audit techniques not included here.

This guide doesn't contain detailed technical information on IRC Section 501(c)(4) organizations. Review the technical information in [IRM 7.25.4](#), Civic Leagues, Social Welfare Organizations and Local Associations of Employees.

## **Background**

IRC Section 501(c)(4) permits an exemption of two very different types of organizations with their own distinct qualification requirements. They are:

- Social welfare organizations - Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, and
- Local associations of employees - membership is limited to the employees of a designated person(s) in a particular municipality, and the net earnings are devoted exclusively to charitable, educational, or recreational purposes.

No net earnings may inure to the benefit of any private shareholder or individual of an organization. See IRC Section 501(c)(4)(B) and IRC Section 4958 which apply to all IRC Section 501(c)(4) organizations.

An organization is considered to operate exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the community's common good and general welfare. See Treas. Reg. 1.501(c)(4)-1(a)(2)(i).

Promotion of social welfare doesn't include any of the following per Treas. Reg. 1.501(c)(4)-1(a)(2)(ii):

- Direct or indirect participation or intervention in a political campaign on behalf of or in opposition to any candidate for public office
- Operating a social club for pleasure, benefit or recreation
- Carrying on a business with the general public in a manner similar to organizations operated for profit

Certain veterans' organizations may qualify for exemption under Section 501(c)(4) because their activities promote social welfare, and not because of the composition of their membership. However, the composition of their membership determines whether

they're eligible for charitable contributions. See the [Audit Technique Guide for Veterans Organizations](#).

Certain homeowners' associations may qualify under IRC Section 501(c)(4) as well, if operated in a manner which promotes the social welfare of the community, rather than the private interests of its members.

### **Organizational Requirements of Social Welfare Organizations**

IRC Section 501(c)(4) provides that social welfare organizations are both:

- Not be organized for profit.
- Operated exclusively to promote social welfare.

To determine if the organizational requirements are met, read the organizing documents and bylaws and verify the organization:

- Meets the "not organized for profit" requirement, and
- Has net earnings devoted exclusively to charitable, educational or recreational activities.

### **Operational Requirements - Social Welfare Organizations**

- To qualify as a social welfare organization under IRC Section 501(c)(4), an organization must be operated exclusively for the promotion of social welfare. This is met if it's primarily engaged in activities which in some way promote the common good and general welfare of the community.
- Activities that don't promote social welfare include political activities, operating a social club for members, and the conducting business with the general public in a manner generally similar to for-profit organizations. Therefore, an organization which is primarily engaged in these non-qualifying activities, doesn't qualify as a social welfare organization under IRC Section 501(c)(4).
- Social activities for the benefit, pleasure, or recreation of members don't promote social welfare purposes and therefore, aren't qualifying social welfare activities. However, these social activities don't preclude exemption under IRC Section 501(c)(4) if they, along with any other activities that don't promote social welfare purposes, are not the organization's primary activities.
- An organization doesn't qualify for exemption as a civic organization described in IRC Section 501(c)(4) if its primary activity is the operation of a social club for the benefit, pleasure, or recreation of its members. See Treas. Reg. 1.501(c)(4)-1(a)(2)(ii).
- Conducting business with the general public in a manner similar to for-profit organizations doesn't promote accomplishing social welfare purposes. However,

conducting business with the general public on a for profit basis, doesn't prevent exemption under IRC Section 501(c)(4), if this business with the general public, along with any other activities that don't promote social welfare purposes, aren't the organization's primary activities.

To determine if an organization is operated exclusively for the promotion of social welfare, identify, review, and analyze:

- Organizing document and bylaws for stated purposes which are inconsistent with the furtherance of social welfare purposes.
- Minutes of meetings, publications, disbursements, and other available documentation to determine the organization's activities, and whether these activities promote the common good and general welfare of the community.

Also, determine whether the organization:

- Conducts activities that benefit a private group of individuals, as opposed to promoting the general welfare of the community
- Carries on a business with the general public in a way similar to for-profit organizations
- Operates a social club for the benefit, pleasure or recreation of its members
- Intervenes or participates in political campaigns for or in opposition to a candidate for public office
- Lobbies to influence legislation which is not germane to, or in furtherance of qualifying social welfare purposes
- Conducts their activities primarily to promote the social welfare of the community as a whole.
- Has unrelated business income, and if so, whether it reported it on [Form 990-T](#), Exempt Organization Business Income Tax Return.

Review the organizing document and bylaws to determine if the organization is a membership organization, and if so, what rights, privileges, services, and activities are offered to members.

- Determine if membership benefits includes nonexempt social club type services, for example, including a bar and restaurant for members.
- Review the minutes, pamphlets, brochures and cash receipts to determine the types of activities, and income from activities the organization carries on for its members.

Review fund-raising activities to determine the extent to which the organization carries on business activities with the general public in a manner similar to for-profit organizations.

If the organization continues to qualify under IRC Section 501(c)(4), for any activities determined not to further social welfare purposes, determine whether it properly reported the activities' income and directly connected expenses on Form 990-T.

### **Legislative and Political Activities**

An IRC Section 501(c)(4) organization's attempts to influence legislation are considered to be activities that further IRC Section 501(c)(4) social welfare purposes if that legislation is germane to accomplishing its social welfare purposes.

In contrast, an organization whose primary activity is lobbying to advance the financial interests of its members, as opposed to promoting the social welfare of the community, doesn't qualify for IRC Section 501(c)(4) status.

The promotion of social welfare doesn't include participation or intervention in political campaigns of candidates for public office. See Rev. Rul. 2004-6 and Rev. Rul. 2007-41 for information on political intervention activity.

However, an IRC 501(c)(4) organization may intervene in political campaigns without jeopardizing its exempt status if it's primarily engaged in other activities which further the promotion of social welfare. See Rev. Rul. 81-95.

- Review minutes, publications, activities, and disbursements to identify any political or legislative activities or expenditures.
- If the organization has any legislative activities, determine whether the activities further social welfare purposes as opposed to a particular industry or profession's specific interests, or serve other nonexempt purposes.
- If the organization has any political activities or expenditures, analyze all activities to determine if the primary activity is the promotion of social welfare as opposed to nonexempt political activities.
- If the organization has any political expenditures, determine whether it filed and reported all required information for [Form 1120-POL](#), U.S. Income Tax Return for Certain Political Organizations.

### **Local Associations of Employees**

To qualify as a local association of employees under IRC Section 501(c)(4) the organization must:

- Be local in character, its membership must be limited to employees of a designated employer(s) in a particular locality, and

- Devote its net earnings exclusively to charitable, educational, or recreational purposes.

For the local requirement, see Treas. Reg. 1.501(c)(12)-1(b) for the definition of local. Business limited only by state borders would not be local.

- Review the organizing document, bylaws, publications, and brochures to determine the membership requirements, and whether membership is properly limited to employees of a designated employer(s) in a particular locality.
- Review minutes, publications, brochures, and expenditures to determine whether the organization properly uses net earnings for charitable, educational, and recreational purposes.
- Review expenditures to check for use of funds for non-qualifying purposes such as the payment of retirement, medical, or similar benefits. These types of uses aren't charitable, educational or recreational.

### **Veterans' Organizations**

Veterans' organizations can be described under IRC Section 501(c)(4) not because of the composition of their membership, but because they're engaged primarily in activities which promote social welfare purposes. This is in contrast to IRC Section 501(c)(19) war veterans' organizations, which are required to meet specific requirements for their membership composition. And for contributions to war veterans organizations to be deductible under IRC Section 170(c)(3), the membership must be made up of war veterans.

Unlike IRC Section 501(c)(19) veterans' organizations, social and recreational activities for members of an IRC Section 501(c)(4) veterans' organization is not an exempt purpose activity even if the members are veterans.

Patriotic activities are considered to promote the common good and general welfare of the community.

See the [Audit Technique Guide for Veterans Organizations](#) for additional examination guidelines and issues common to veterans' organizations.

- Interview appropriate organization officials, tour facility, review minutes, receipts and expenditures to determine if the organization's activities include social and recreational activities for members, or other nonexempt activities.
- If the organization has a bar for members, determine if it is a separate corporation, which may qualify under IRC Section 501(c)(7). Request a copy of the exemption letter to verify exempt status.
- If there is a related separate entity, inspect copy of the Form 990 for that entity, and determine whether to expand your exam to include it.

- Analyze cash receipts and supporting documents to identify any unusual or potentially taxable sources of income, operation of a banquet hall, sale of liquor for consumption off premises, etc.
- To determine if the organization is eligible to receive deductible contributions, review the organizing document and bylaws to determine membership requirements, and review the membership records to see if the contributions satisfy deductibility requirements.

### **Homeowners' Associations**

A homeowners' association is an organization of all of a development's lot owners that enforces covenants to preserve the architecture and appearance of the development. It also generally owns and maintains certain common green areas and sidewalks.

Members' dues and assessments generally support these organizations.

To meet IRC Section 501(c)(4) a homeowners' association must:

- Serve a "community," an area bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or unit thereof,
- Not perform exterior maintenance on private dwellings, and
- Open the facilities the association maintains to the general public rather than restricting access to members only.

Depending on the activities, and the choice of the organization, a homeowners' association may also qualify for the elective exemption under IRC Section 528. See Rev. Rul. 74-99 and Rev. Rul. 80-63.

- Inspect the property and facilities for indications that the general public is restricted to property and facilities that the association owns and maintains (such as No Trespassing Signs, gates blocking access).
- If the organization restricts access to its facilities, ask the officers if a separate organization holds title to the restricted access facilities. For example, a clubhouse which serves as a gathering place for members' social and recreational programs and activities could be a separate IRC Section 501(c)(7) organization. Secure a copy of the exemption letter to verify its status.
- Read the covenants and minutes of association meetings, and review disbursements and other financial records to determine if the association performs exterior maintenance on private dwellings.

### **Inurement Prohibition**

An organization can't qualify under IRC Section 501(c)(4) as a social welfare organization or as a "local association of employees" unless no part of its net earnings

inures to any private shareholders' or individuals' (insiders) benefit. See IRC Section 501(c)(4)(B).

- Review minutes, expenditures, and financial records for indications of questionable transactions with insiders, officers, trustees, and key employees, which may result in prohibited inurement.
- Determine whether IRC Section 4958 excess benefit transaction provisions apply to questionable insider transactions. See [IRM 7.27.30](#), Taxes on Excess Benefit Transactions for information on IRC Section 4958.