DRAFT

LEAGUE OF WOMEN VOTERS

CONVERSION FROM
IRC SEC. 501(C)(4) TO
SEC. 501(C)(3)

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FOREWORD

This document is designed to set forth a general description of the issues which may be involved in the conversion of a League of Women Voters from a tax exempt status under IRC §501(c)(4) to a similar status under IRC §501(c)(3). Although most Leagues are very similar in their operations, there are occasions where an individual League may differ in a significant way in one or more areas from which is described in this document. Accordingly, if any League is considering such a conversation, they should contact Tom Carson [(818) 840-0417[tpcarson@outlook.com], the author of this document, or Greg Leatherwood, Director of Finance at LWVUS [(202) 429-1965 x 308, GLeatherwood@lwv.org] before proceeding, to be sure that all important issues for that League are addressed.
Background

Different types of organizations can qualify as tax exempt under Internal Revenue Code §501(c)—e.g., charities, churches, schools, hospitals, trade associations—and each type has its own specific rules under the Internal Revenue Code.

For example, historically most Leagues have qualified as tax exempt organizations under §501(c)(4), which covers organizations promoting social welfare. Such organizations are permitted to be significantly involved in political campaigning, but of course League of Women Voter policies prohibit support of candidates or political parties. §501(c)(4) puts no limits on either advocacy or lobbying activities. (See Appendix III for additional information about what activities constitute lobbying.) On the other hand, dues and contributions paid directly to such organizations are not tax deductible to their members and/or donors.

Entities organized and operated exclusively for charitable, education, scientific, etc. purposes normally qualify as tax exempt under §501(c)(3). Historically this is the way that local and state League Education Funds have qualified. §501(c)(3) organizations cannot be involved in political campaigns, but again that is not an issue for Leagues. Although League Education Funds have self-limited their activities to exclude advocacy, under the tax rules there are no limits at all on pure advocacy (whether measure by time or dollars spent) by such organizations, although there are potential limits on lobbying activities. By contrast to §501(c)(4) organizations, dues and contributions paid to §501(c)(3) organizations are tax-deductible by individuals who itemize their deductions, excluding contributions which are specifically designated by the donor to fund a lobbying expenditure, or to the extent the member or donor receive something of value in exchange for the dues or contribution.

The ability to conduct advocacy and lobbying activities are very important for League members. As noted above, there is no limitation at all on pure advocacy under either §501(c)(3) or (c)(4). On the other hand, lobbying activities, which are activities addressed to or about specific legislation or ballot propositions (i.e., for Leagues, “action”), cannot constitute a “substantial part” of the overall activities of a §501(c)(3) organization. Provided that the appropriate election is made under §501(h), the measurement of lobbying for purposes of this “substantial part” test is based on dollars spent rather than time spent, and the threshold is not met for organizations of League size unless lobbying expenditures exceed 20% of an organization’s total annual expenditures.

The §501(h) rule is favorable to Leagues, because with the exception of LWVUS and some state Leagues, lobbying is normally conducted by members on a volunteer basis, with little or no out-of-pocket expenditures. Local Leagues frequently lobby at City Councils or School Boards or County Boards of Supervisors, but these activities typically do not involve out of pocket expenditures. Even LWVUS and state Leagues which have staff involved in lobbying do not come close to the 20% threshold. So from a practical standpoint the §501(c)(3) limitation on lobbying activities would not impose any practical limitations on local or state League lobbying activities or operations. See Appendix III for a further discussion of lobbying.
At the same time, §501(c)(3) organizations must definitely keep track of their lobbying expenditures within their accounting records so that upon any IRS audit they could demonstrate that there has been no violation of the “substantial part” test. If a League files Form 990 or 990-EZ, it must complete Schedule C, Part II-A regarding its lobbying expenditures, etc.; Leagues filing e-Postcards do not have this reporting obligation. Some states also require filings on this subject, even if the League only files a state e-Postcard.

**Actual §501(c)(3) Conversions of State and Local Leagues of Women Voters**

As of March 2015, 17 California local Leagues have converted from §501(c)(4) to §501(c)(3) status, some in 2011 and some in 2014, with additional ones currently in the process of conversion. Four years ago LWV Wisconsin, along with its 17 single entity local Leagues, converted to §501(c)(3). In 2013 LWV Minnesota converted, and is still in the process of getting its 34 local Leagues to convert as well. Most of these Leagues were single entities, but a number already converted or in the process of converting are dual-entity Leagues consolidating into a single §501(c)(3) entity. From discussions with the leaders of all of these converted Leagues, none have found any problems or unforeseen consequences resulting from their League’s conversion of status.

**Pros and Cons of Applying to Change from §501(c)(4) to §501(c)(3)**

The greatest potential benefit from a local League qualifying under §501(c)(3) would actually be the benefits to its members because all of the membership dues and contributions needed for their operations would be tax deductible to members and donors who itemize their deductions (again, except for contributions which are specifically designated by the donor to fund a lobbying expenditure, or to the extent the member or donor receive something of value in exchange for the dues or contribution). Members/donors can currently receive tax deductions for contributions to a local League’s Ed Fund at LWVUS or their state League, but those contributions cannot be used for a significant portion of a League’s normal operating budget. Consolidation would allow deductibility for all funds needed to support a League’s total budget.

It is certainly likely that most Leagues will achieve some increase in contributions after a conversion, but it will be difficult to calculate how much because of all the different factors which impact on contributions levels from year to year. In any event, deductibility is probably not likely to motivate a person to make a contribution if they are not interested in the League’s mission, but larger contributors not infrequently look at the after-tax cost of contributions, and adjust the amount of their contribution based on tax deductibility.

As a general matter, agencies and foundations are willing to give grants to §501(c)(3) organizations but not to many other types of exempt organizations. So conversion would give local Leagues greater opportunities to obtain such grants if they are available in their communities. Further, some vendors (e.g., PayPal) give discounts to §501(c)(3) organizations but not other tax exempt organizations; also, companies like Amazon have donation programs for such organizations.
Conversion will reduce the workload for local and state League, as there will no longer be any need to have tax-deductible contributions be sent to an Ed Fund account at either LWVUS or a state League, or to have to seek reimbursements sent back to a League. Additional workload reductions are possible for dual-entity Leagues which consolidate into one organization.

Concerns have been raised by some individuals that under §501(c)(3) Leagues would have to stop all advocacy, but; as noted above, this is entirely erroneous. The actual limits on lobbying expenditures is very unlikely to impact any League.

Concerns have also been raised that there is a horrendous burden in bookkeeping and governmental reporting; this also is entirely erroneous.

There have also been questions raised about the tax consequences of a §501(c)(3) organization making large annual Per Member Payments to LWVUS, which is §501(c)(4), and many state Leagues which are also still §501(c)(4). The issue of PMPs, how they are calculated, how the recipients can and do use these funds, why they should be considered to be exempt purpose expenditures for §501(c)(3) organizations, etc., were explored in extensive detail during the IRS’ review of several California local League’s Form 1023 applications to qualify under §501(c)(3), and all of these issues were resolved favorably so that the IRS approved these League’s applications. See Appendix IV for more details on this issue.

Finally, concerns have been raised about having to send thank-you letters to contributors to ensure tax deductibility. Of course the IRS does require written confirmation of individual contributions of $250 or more. It would be expected that all League already are thanking any person making such a significant contribution, so there would be no incremental burden from converting to §501(c)(3). Actually, many League write thank-you letters every year to every single contributor, no matter how small the amount.

**Steps to Convert Single-Entity Leagues to §501(c)(3)**

(1) If a League wishes to convert to §501(c)(3), it must amend both its articles of incorporation and its bylaws to include specific language which is required by the IRS. If a League is unincorporated, it must amend its bylaws or articles of association.

(a) First, within the purposes sections of these documents, the following language should be inserted in its entirety, either as a replacement to existing language referencing §501(c)(4) or just as additional language:

> This corporation is organized and operated exclusively for charitable and educational purposes under Section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code. Notwithstanding any other provision of these Articles, the corporation shall not carry on any other activities not permitted to be carried on by a corporation exempt from Federal
Income Tax under such provisions of the Internal Revenue Code. No substantial part of the activities of the corporation shall be attempting to influence legislation.

(b) Secondly, the following language should be inserted as a “dissolution” clause, either to replace existing language or as additional language. The IRS requirement is that the assets upon dissolution must go to another §501(c)(3) organization. Many Leagues currently specify either the LWVUS or their state League as the named recipient upon dissolution, but at the present time the LWVUS and most state League are §501(c)(4) organizations, and are not eligible recipients under a §501(c)(3) dissolution clause. Of course some state Leagues have converted to §501(c)(3) status, and others are considering conversion, but the following language meets the IRS requirement while providing flexibility as to the appropriate League recipient entity:

In the event of the merger or dissolution of this corporation for any reason, all money and securities or other property of whatsoever nature which at the time be owned or under the absolute control of the corporation shall be distributed at the discretion of the board, or such other persons as shall be charged by law with the liquidation or winding up of the corporation and its affairs, to any member organization of the League of Women Voters national organization which is exempt under Section 501(c)(3) of the Internal Revenue Code or the corresponding section of any future federal tax code; or if none of these organizations are then in existence or exempt under those tax provisions, then, at the discretion of the board, to another organization which is organized and operated exclusively for charitable and educational purposes and which has established its tax-exempt status under such designated tax provisions.

Many League bylaws provide that the bylaws can only be amended at an annual meeting or convention; a few allow special member meetings to be called for this purpose. Typically there is nothing in League articles or bylaws about the appropriate way to amend articles of incorporation, although there may be general provisions in state corporation codes. But most Leagues have concluded that they should amend their articles following the same procedures applicable to bylaws amendments. In any event, all amendments to the articles of incorporation typically have to be filed with a state agency, often a state’s Secretary of State’s office in order to be legally effective.

A number of states classify tax exempt organizations as either “public benefit corporations or organizations” or “mutual benefit corporations or organizations.” The first classification usually includes §501(c)(3) and (c)(4) organizations, while the second classification includes other exempt organizations such as social clubs, trade associations, etc. Almost all Leagues in these states would naturally be classified as public benefit corporations, but for various reasons a number have been misclassified as mutual benefit corporations. It will be necessary to first have this misclassification corrected before a League can file amendments to convert it to §501(c)(3) status.
(2) If a League has had revenues of $50,000 or less in each of the preceding three years; projects no more than $50,000 in revenues in each of the next three years; and does not currently have assets in excess of $250,000 (which obviously is true of most local Leagues and some state Leagues), then that League can file an online Form 1023-EZ application with the IRS to qualify under §501(c)(3). The League must first complete a 10 page questionnaire which is included in the Form 1023-EZ Instructions, but there should be no problem for a League organization of this size to successfully complete the questionnaire. The Form 1023-EZ itself is a simple four page form; payment of a $400 fee is necessary to complete the filing. (See Appendix I for a discussion about certain of the questions included in the application.) This is an automatic application, with no IRS review. An IRS determination letter recognizing the filer’s §501(c)(3) status currently is being issued in 3-4 weeks.

It is possible that there are Leagues which cannot meet those financial parameters, they will have to file a full Form 1023 application for conversion, which is not automatic but subject to review by an IRS agent.

(3) Many state tax authorities will automatically follow the IRS’ determinations on qualification for a particular exempt status. However, in some instances the League may have to file a form with its state taxing authority about its new tax status, and transmit a copy of its IRS determination letter.

(4) The League will have to file a Form 5768 with the IRS, making the election under §501(h) to measure lobbying activities by dollars spent rather than time spent.

(5) The League should request from either LWVUS or its state League a refund of all funds held for it in its Ed Fund account.

(6) The League should update its website to reflect its new tax status, and seek other ways to publicize this conversion.

(7) The League should notify Greg Leatherwood, the Chief Financial Officer of LWVUS (GLEatherwood@lwv.org), of its successful conversion.

(8) If the local League was included in a §501(c)(4) group exemption, it will have to withdraw from that exemption because all organizations within a group have to be exempt under the same Code section. At the time it files the Form 1023-EZ, it should notify its state League that it is withdrawing its existing authorization to the state League to be included in the group. That way there will be no gap in its exempt status.

Each such local League will have to contact the IRS Exempt Organization office at (877) 829-5500, and request that the IRS establish a “data sheet” for it in the IRS system. In order to be eligible to do this, it must be qualified as an exempt organization, and have the appropriate organizational documents (i.e., articles of incorporation and/or bylaws), although it will not have to provide copies of these to the IRS at the time of the call.

See Appendix V for a more detailed look at group exemptions.
Steps to Convert Dual-Entity Leagues to §501(c)(3)

Some local Leagues and many state Leagues have a dual structure: the League entity is qualified under §501(c)(4) and its related Education Fund is qualified under §501(c)(3). Conversion to §501(c)(3) status may be achieved by consolidating the assets and operations of the League entity into the related Education Fund. The following steps are needed to achieve the desired result (see also Appendix II for a projected timeline for this process):

(1) It should be relatively easy to transfer basic League assets, such as cash, securities, furniture, files, etc. to an Education Fund. However, a League may have other assets, or contractual arrangements such as office or copier leases, which can be more complex to transfer, and sufficient time must be allowed to address these issues.

(2) Both the League entity and the Education Fund must amend both their articles of incorporation and their bylaws to include specific language which is required by the IRS, as described in item (1) in the immediately preceding section.

Typically the Education Fund will change its name to that of the League entity’s traditional name, and the League entity will adopt new name, such as “League of Women Voters of XXX Advocacy Fund.” Perhaps the easiest way to amend the Education Fund’s bylaws is to have the Education Fund adopt the existing League entity’s bylaws. These bylaws are familiar to members, and have been designed specifically for the kind of entity the Education Fund is to become.

When the League of Women Voters of Wisconsin consolidated its operations into its Education Fund, it decided to keep its former state League entity in existence for possible use in the future for significant lobbying activities. This precedent has been followed by other dual-entity Leagues even though LWV Wisconsin has since decided to dissolve its former League entity because it has not found any real use for it. But if preserved, the League entity will typically become a non-member organization, with much simplified bylaws because it is likely to be inactive for the near future.

(3) There should be no need to file any kind of application with the IRS regarding this consolidation. The Education Fund will already have a determination letter regarding its status under §501(c)(3), and it is very clear that adding the assets and operations of the League entity should not put that status in jeopardy, as witnessed by the many Leagues which have already qualified under §501(c)(3). However, any League which has to file the Form 990-EZ or 990 will have to file copies of its newly amended bylaws with the next federal return, with explanation of the significant changes from its prior bylaws. This requirement may also be true for state income tax filings.

(4) In some states, a League may have to apply to a state agency which governs exempt organizations for review or approval of the transfer of assets/operations out of the exempt organization, so that the agency can be comfortable that the assets are not being diverted from their exempt purpose. For example, in California a consolidating League must apply to the Registry of Charitable Trusts within the California Attorney General’s office in advance of the
actual transfer so that this agency may be satisfied that the assets are maintained for their intended purpose.

(5) The Education Fund will have to file a Form 5768 with the IRS, making the election under §501(h) to measure lobbying activities by dollars spent rather than time spent.

(6) If a local League Education Fund, it should request from either LWVUS or its state League a refund of all funds held for it in its Ed Fund account.

(7) The Education Fund should update its website to reflect its new tax status, and seek other ways to publicize this conversion.

(8) The League should notify Greg Leatherwood, the Chief Financial Officer of LWVUS (GLeatherwood@lww.org), of its successful conversion.

(9) If the consolidated League is a state League which has obtained a group exemption for its local Leagues, the consolidation process will result in that state League ceasing to qualify as the “central organization” of its group, and the group exemption will no longer be in effect for any of the local Leagues. Each such local League will have to contact the IRS Exempt Organization office at (877) 829-5500, and request that the IRS establish a “data sheet” for it in the IRS system. In order to be eligible to do this, it must be qualified as an exempt organization, and have the appropriate organizational documents (i.e., articles of incorporation and/or bylaws), although it will not have to provide copies of these to the IRS at the time of the call. Any such local League should be able to qualify as tax exempt under §501(c)(4) as it was so qualified under the group exemption.

See Appendix V for a more detailed look at group exemptions.
APPENDIX I; COMMENTS ON COMPLETING FORM 1023-EZ

The following are suggestions and comments on ways to complete certain of the questions on the Form 1023-EZ.

Part I, Line 8. The form requests information about the filing organization’s officers and directors. It only provides space for five people, and that’s all the IRS wants. Page 3 of the Form 1023-EZ Instructions provides an explanation of how to pick the five to report on.

Part II, Lines 5, 6 and 7. You have to be able to check each of these boxes or your application will fail. However, you should be able to check these boxes if you have followed the instructions in this document on amending your League’s Articles of Incorporation and Bylaws.

Part III, Line 1. The appropriate code to be used is W99.

Part III, Line 2. It is suggested that the box be checked for “Charitable” and “Educational.”

Part III, Line 4. Answer this question “Yes.”

Part II, Lines 5-11. You should be able to answer all of these “No.” Line 6 does not refer to the reimbursement of League expenses previously paid by others.

Part IV, Line 1. The box for item “b” should be checked.
APPENDIX II: PROJECTED TIMELINE FOR CONSOLIDATION OF A LEAGUE AND ITS EDUCATION FUND

GOAL: After consolidation, LWVXXX will be a §501(c)(4) non-member shell corporation and its Education Fund will be a §501(c)(3) membership organization with all of the LWVXXX assets and operations.

1. In _____, the Boards of Directors of both LWVXXX & Education Fund approve consolidation and related steps and recommend approval to members for action at the LWVXXX (and Education Fund) Annual Meeting.

2. Following step (1), but before LWVXXX Annual Meeting, the Education Fund Board takes the following steps, all contingent on LWVXXX member approval of consolidation:
   a) change name of Education Fund by amending Articles of Incorporation to LWVXXX;
   b) amend Articles of Incorporation to strengthen §501(c)(3) provisions; and
   c) restate Education Fund Bylaws to (i) change its name, (ii) strengthen the §501(c)(3) provisions and (iii) make it a membership organization (most likely done by using existing LWVXXX Bylaws as a format).

3. At its Annual Meeting, LWVXXX members:
   a) approve consolidation;
   b) change name of LWVXXX to LWV____ by amending Articles of Incorporation;
   c) amend dissolution clause in Articles of Incorporation to permit distribution of assets to a §501(c)(3) organization;
   d) restate Bylaws to (i) change its name, (ii) make it a non-member organization, and (iii) simplify officer/director structure; and
   e) adjourn LWVXXX annual meeting.

4. Education Fund opens its annual meeting:
   a) Board admits all pre-existing LWVXXX members as Education Fund members;
   b) members approve any further amendment of the Bylaws;
   c) members elect officers and directors; and
   d) members approve budget and program.

5. Completion steps (some of these vary by state, but there are likely to be such requirements in most states):
   a) If needed, LWVXXX obtains approval from any state agency with oversight over exempt organizations for the transfer of assets to Education Fund;
   b) LWVXXX files Certificate of Amendment of Articles with the appropriate state agency with oversight of corporations;
   c) After receiving necessary approvals, LWVXXX transfers assets to Education Fund except for any necessary holdback;
   d) Employees (if any) transfer to payroll of Education Fund;
   e) After LWVXXX receives certification of its Articles Amendments, Education Fund files its Certificate of Amendment of Articles with the appropriate state agency;
   f) Education Fund files Form 5768 to elect to measure lobbying activities by dollars spent.

APPENDIX III: KEEPING RECORDS ABOUT LOBBYING EXPENDITURES
Background

The definition of “lobbying” for tax purposes is closer to the League concept of “action” than the broader term “advocacy;” lobbying is a subset of advocacy. The key concept is that advocacy will not constitute lobbying if the advocacy does not involve a reference (a) to specific proposed legislation, or (b) to a referendum, initiative, constitutional amendment, or similar procedure which will appear on a ballot.

There are two types of lobbying--direct lobbying and grass-roots lobbying. The term “direct lobbying” in turn includes two types:

(a) communications with any member or employee of a legislative body, or with any other government official or employee who may participate in the formulation of legislation, to support or oppose a specific piece of legislation; “legislation” includes the introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items, but does not include actions by executive, judicial, or administrative bodies.

(b) attempting to influence the public (including our members) to support or oppose specific measures to be placed on a ballot.

By contrast, “grass roots lobbying” means communications with the public (including members) to urge them to contact their legislator, etc., to support or oppose specific legislation.

Types of Expenditures

The most common, though not necessarily frequent, type of lobbying for local Leagues is to support or oppose legislation at their local government level: County Board of Supervisor, City Council, Board of Education, etc. This may involve either a League member attending a meeting of the applicable legislative body to make a verbal presentation on behalf of their League, or writing a letter to the editor of the local newspaper. If this is done by a member volunteer, there may be relatively minor related out-of-pocket expenses for mileage or parking or printed handouts, which would all be classified as direct lobbying expenditures if incurred. Even if reimbursement is possible under the local League’s policies, many members never seek reimbursement. It would be better if they did turn in an expense report providing the details of the expenses, but still refusing to accept reimbursement.

If the League also communicated with its members and friends, asking them to support or oppose this local legislation by contacting their appropriate representative(s) to vote for or against the legislation, the cost of this communication would be classified as grass roots lobbying.

Another common type of League lobbying is to communicate to members and friends the positions of the local League on a local ballot measure, etc., and/or the state League on statewide ballot propositions. These may be reproduced in the League’s VOTER, other member communication, on the League website, as an advertisement in local media, or even printed for local distribution. The costs of the VOTER, member communication, website, etc., allocable to the local
or state League content would all be direct lobbying expenditures, as would the cost of any advertisement or handouts.

If League employees are involved in the foregoing activities by help prepare for testimony or communicating with member or friends, a portion of their “cost” must also be identified and recorded as direct and/or grass roots lobbying expenditures. When allocating a portion of the costs of employees, it is necessary to determine the “fully-loaded” costs of the time spent by the employee to directly conduct lobbying activities or to support League members conducting lobbying activities. “Fully-loaded” means that the appropriate costing includes not only direct payroll costs, but also employee benefits plus an allocable share of office expenses such as rent, communications, etc. The time spent arranging meetings, preparing materials for meetings or mailings, as well as the costs thereof, would also be included.

If League members use the League’s office for meetings or other work directly related to the lobbying activities, it will also be necessary to calculate the “cost” of the space or other assets so utilized for the time period involved. Of course, a ‘rule of reason’ should apply to avoid incredibly detailed calculations for very small items.

It is possible that an allocable portion of Per Member Payments may be classified as lobbying expenditures because of the lobbying activities of LWVUS and state Leagues; further research is currently being done on this issue. If necessary, it will be the responsibility of LWVUS and the state Leagues to provide to local Leagues the appropriate lobbying percentages for both direct lobbying and grass-roots lobbying. In the last three years, LWVUS’ percentages have ranged from 4.0 to 4.68% for direct lobbying and 2.36 to 3.97% for grass-roots lobbying. State League percentages, except possibly for the largest state Leagues, are likely to be a lesser percentage.
APPENDIX IV: TAX ASPECTS OF PER MEMBER PAYMENTS BY LOCAL LEAGUES

Executive Summary

For most local Leagues, Per Member Payments ("PMPs") due to their regional and state Leagues and the League of Women Voters of the United States ("LWVUS") represent a significant portion of their total annual expenses. Accordingly, when several years ago several local Leagues in California applied to the IRS to convert their tax exempt status from §501(c)(4) to §501(c)(3), we had lengthy discussions with the IRS reviewing agents as to whether the Leagues could qualify for §501(c)(3) status with so much of their budgets being transferred to §501(c)(4) organizations.

After extensive discussion with the IRS agents about how the PMPs are determined and how the funds are utilized by the higher level Leagues, the agents agreed that the PMPs should be classified as qualifying §501(c)(3) exempt purpose expenditures for the local Leagues, and approved their §501(c)(3) status. Although the IRS never raised the issue, this conclusion should also confirm that there should be no restrictions on how the higher level Leagues use the PMP funds in accordance with their budgets, as any of their expenditures could also qualify as exempt purposes expenditures for a §501(c)(3) League organization.

Without much detailed discussion on either side, during the course of the IRS review a consensus evolved that to the extent that the higher level Leagues incur lobbying expenditures, then a proportionate part of the local League’s PMPs would be classified as direct lobbying expenses or grass roots communications for purposes of the local League’s "substantial part" test under §501(c)(3). At the time, there was no regulatory or other guidance on this issue. However, based on a subsequent IRS ruling, and further research detailed below, it now seems clear that no part of the PMPs should be classified as lobbying expenditures.

An additional issue, which again was never raised by the IRS during their review of the Leagues’ applications, is whether any portion of membership dues paid to a §501(c)(3) local League would not be deductible to the member because of their League’s PMPs. However, as a general matter all dues and donations to such local Leagues are deductible under §170(a), and there is nothing about the nature of PMPs which would cause an exception to this general rule.

Detailed Discussion of the Issues

Factual Background

All local Leagues pay annual PMPs to their state League and to LWVUS, and some Leagues also pay PMPs to regional Leagues. LWVUS, regional Leagues and all but two state Leagues have always been §501(c)(4) organizations. The PMPs are calculated at annually determined dollar rates established for each of these higher level Leagues, multiplied by the number of a League’s members in each category (individual, household, lifetime and student) as of January 31st of each year, payable in quarterly installments over the following fiscal year. Accordingly, the annual amount of the PMPs are a fixed obligation prior to the start of each League’s fiscal year, and are not payable out of, or calculated as a percentage of, the membership dues revenue received by a local League. The rate per member is approved as part of the higher level Leagues’ budgetary processes, which
require the approval of the local Leagues at the higher Leagues’ annual meeting, convention or council.

PMP revenues for LWVUS and larger state Leagues typically average about 20-25% of their total annual revenues, but may be a higher percentage for small Leagues. Leagues at all levels have other sources of revenue such as donations, grants, honoraria, investment income, etc.

LWVUS, state and regional Leagues basically perform two roles: (a) providing services directly to and for the benefit of the Leagues in their exempt purpose operations; and (b) performing exempt purpose activities in those situations where it is not practical for such activities to be conducted individually by the Leagues (including lobbying at the regional, state or national government level).

Characterization of Per Member Payments

PMPs are a form of general funding support for the higher level Leagues, providing those Leagues with part of the financial resources they need to perform their services and activities to/for the local League and to cover their administrative expenses. None of the higher League PMP revenue sources are earmarked for any particular purpose. The IRS agents were provided with a lengthy and detailed written discussion of the kinds of support services provided to local Leagues in California by LWVUS and the League of Women Voters of California (“LWVC”). Additional information was provided about the activities which these higher level Leagues perform at their own level of government on behalf of the local Leagues because it would not be practical for local Leagues to undertake such activities individually. (Other state Leagues and regional Leagues provide varying levels of similar services and activities, depending on their size and financial resources.)

These services are directly valuable to Leagues in performing their exempt purpose operations, which is precisely why the Leagues provide support through their PMPs—so that they can benefit from these services. Equally important is the fact that the local Leagues realize significant cost savings from such services. It is not unusual that a League's cost savings in these areas actually offset the total cost of that League’s PMPs.

Control Over Exempt Purpose Expenditures

Given that the higher level Leagues are §501(c)(4) organizations, the IRS reviewing agents were also concerned as to how the local Leagues could be assured that the higher level Leagues would continue to expend the PMP funds in the manner we had described. We noted that the local Leagues have the right to elect all of the officers and directors of these higher level Leagues, and approve their annual budgets which control the way that the higher level Leagues determine their expenditures. Thus it is clear that because of these voting rights the local Leagues exercise an ongoing element of “control” over the operating plans which determine the expenditures of the higher level Leagues.

In light of what we described above, the IRS agents were satisfied that the local Leagues could be assured that the PMP funds would continue to be used in the manner described.

Membership Dues
The members of each local Leagues elect its officers and directors, and approve their annual budgets, including the level of the annual membership dues and the way that the League plans its expenditures. There is no “earmarking” of the use of the dues revenue for particular purposes; the dues are just part of the overall financial support of the local Leagues, typically probably less than half.

**Tax Treatment of Per Member Payments**


The key element in the request which resulted in the ruling was the conceptual framework in certain private foundation regulations which address what constitutes a private foundation’s lobbying expenditures which may be subject to the excise tax imposed by §4945. In this private letter ruling the IRS agree to extend the conceptual framework set forth in regulations covering the characterization of grants made by private foundations to similar types of grants made by public charities, since there are no similar regulations about public charity grants. The following language is an excerpt from the Alliance for Justice’s private letter ruling:

Under section 53.4945-2(a)(6)(i) of the regulations, general support grants by private foundations to public charities are not treated as expenditures for lobbying...so long as the grant is not earmarked for lobbying. No comparable provision expressly addresses the treatment of a grant from one public charity to another public charity. However, the standard for public charities should be no more stringent than that which applies to private foundations, as such an approach is consistent with the extensive legislative history and Code provisions that indicate a Congressional intent to encourage grantmaking and advocacy by public charities while penalizing private foundations that earmark grants to support lobbying.

Consequently, general support grants from you [the Alliance for Justice] to another public charity may be treated as non-lobbying expenditures so long as they are not earmarked for lobbying, even if some or all of the funds are ultimately expended by the recipient charity for lobbying....

For the reasons stated previously, the standard for public charities should be no more stringent than that which applies to private foundations. Therefore, as a public charity, your grants restricted for use within a specific project of a grantee public charity will not, solely by virtue of that restriction, be considered earmarked for lobbying. Your grants to a public charity for a specific program will not be considered earmarked for lobbying so long as the grant, combined with all other grants by you for that program during the year, do not exceed the amounts budgeted for non-lobbying activities. If your grants do exceed the amount budgeted for non-
lobbying activities, the amount in excess of the non-lobbying activities will be considered a lobbying expenditure.

IRS private letter rulings can only be relied upon by the person or entity to which it is addressed. However, it is certainly possible to follow the IRS technical analysis in such a ruling and see if it is also appropriate in another situation. In this ruling the IRS concluded that it was appropriate to adopt the conceptual framework of specific private foundation regulations and apply them to a public charity in a situation outside of §4945. Therefore it would not be inconsistent to use this same regulation’s analytical approach to public charities in similar tax situations without relying specifically on that letter ruling.

If the higher level Leagues are exempt under §501(c)(3), as several already are and more in the process, then the fact pattern of the PMPs transferring from one public charity to another would fit right within the public letter ruling template. However, even if the higher level Leagues are exempt under §501(c)(4), it would seem appropriate that the conceptual framework of the ruling should still be applicable. The operations of the higher level Leagues are essentially the same under either exempt status, and in light of the IRS reviewing agents’ determination that PMPs essentially qualify as §501(c)(3) exempt expenditures to local League, this conclusion makes even more sense.

As discussed earlier, PMP revenue are not earmarked within the higher League budgets; rather the local Leagues’ are contributing general support funding for the higher level Leagues. Following the above regulation’s analytical approach, local League PMPs therefore should not be characterized as lobbying expenditures unless these revenues are in excess of the recipient higher level League’s non-lobbying expenditures. Collectively (not measuring on a per-League basis) PMP revenues payable to any higher level League would be extremely unlikely to ever exceed the non-lobbying expenditures of that recipient League, since these normally are in excess of 90% of a League’s total expenditures.

There do not appear to be any other regulations applicable to accounting for lobbying expenditures in this type of situation. So there are no conflicts following the conceptual framework used by the IRS in the private letter ruling, and twould clearly lead to the conclusion that no portion of a local League’s PMPs should be classified as lobbying expenditures.

**Deductibility of Membership Dues**

In the situation of local Leagues qualified as exempt under §501(c)(3), the general rule would be that League membership dues would be fully deductible under §170(a) in the absence of any specific statutory or regulatory exceptions. For example, the dues would not be deductible (a) to the extent that the member has received a benefit because of the contribution; or (b) to the extent that the contribution has been specifically “earmarked” by a donor or member to fund a lobbying expenditure of the League, and the amount has been so used by that League. Neither of those exceptions are applicable in our situation.

As discussed earlier, membership dues are not earmarked for any specific expenditure; they are just part of the overall funding of League activities. Therefore, it is clear that membership dues should be fully deductible for any member who itemizes deductions for tax return purposes.
APPENDIX V: IMPACT ON GROUP EXEMPTION FROM CONVERSION TO §501(c)(3)

Certain state Leagues in the past have applied for a group exemption under §501(c)(4) for all of the local Leagues in their state. Pursuant to the rules governing group exemptions, each state League must submit an annual report to the IRS describing the addition of any new local Leagues in their state (excluding Education Funds, which are exempt under §501(c)(3)) to the group, and the removal of any local League which have gone out of existence.

Some state Leagues are contemplating the consolidation of the assets and operations of their League entity into their Education Fund, which is tax exempt under §501(c)(3). As part of that consolidation, the League organization will likely remain in existence for some period of time after such a consolidation. Similarly, a number of the local Leagues in the same states are considering conversion to §501(c)(3) tax status.

The question arises as to the potential impact on the existence of the group exemption from the consolidation of the state League entities or the conversions by local Leagues.

1. The initial requirements1 for obtaining a group exemption include the following:

   a) The “central organization” (i.e., the state League entity) must be an exempt organization.
   b) The central organization must have subordinates (i.e., its local Leagues) which are affiliated with it and subject to its general supervision or control.
   c) The application must be for a common tax status for all subordinate members (in this case, §501(c)(4)).
   d) Each subordinate must authorize the central organization to include it in the group exemption application, or later in the group exemption itself.

2. Continued effectiveness of a group exemption letter is based on the following conditionsii:

   a) Continued existence of the central organization, and its continued qualification under §501(c).
   b) Annual filings by the central organization as to changes to the group, together with its own annual information returns (e.g., Form 990 or 990-EZ).

3. Continued effectiveness of a group exemption as to a particular subordinate is based on the following conditionsiii:

   a) Conformity of the subordinate with all of its original qualifying conditions.
   b) Filing of any necessary annual information returns by the subordinate.

4. A group exemption letter shall cease to have effect either as to a particular subordinate or to the group as a whole when a central organization notifies the IRS thativ:

   a) It is going out of existence, or
   b) The subordinate no longer fulfills all of the original qualifying conditions. For example, the subordinate may have ceased to exist, changed its tax status to be
different from the group’s status, disaffiliated from the central organization, or withdrawn their authorization to the central organization.

For subordinate organizations which are covered by a group exemption and which file e-Postcards (Form 990-N), the IRS shows the name of the central organization as the “legal” name of each subordinate organization, and their actual legal name as a “doing business as” name.

**Impact of a Local League Converting to §501(c)(3)**

If one or more local League decide to convert to tax exempt status under §501(c)(3) by filing a Form 1023-EZ application with the IRS, they should concurrently contact their state League and withdraw their authorizations to be included in the group exemption. Following item 4(b) above, the group exemption would immediately cease to have effect as to such Leagues, but would continue to have effect as to the other Leagues which have not withdrawn their authorization and remain qualified under §501(c)(4). The effective date of the conversion to §501(c)(3) status is the date when the particular League files its Form 1023-EZ application online, so there would be no gap between a League’s group exemption status under §501(c)(4) and its new separate exempt status under §501(c)(3).

If a League does convert to §501(c)(3) it should contact the IRS Exempt Organization Help Line, (877) 829-5500, and ask to have a “data sheet” set up in the IRS system, and then its subsequent e-Postcard filing will reflect its actual legal name.

A dual-entity local League may be in a different situation because of its dual structure with its Education Fund. If the local League were to convert to §501(c)(3) status by consolidating its assets and operations into its Education Fund, and if the local League entity itself continues in existence even if inactive, then it would remain covered by the group exemption.

**Impact of Consolidation of the state League Entity into its Education Fund**

As noted above, the existence of the group exemption will continue in effect only as long as a state League entity (a) continues in existence and (b) continues to function as the “central organization.”

In order to function as the central organization, the subordinate organizations covered by the group exemption must remain “affiliated” with the central organization and remain subject to its “general supervision or control.” There is no explanation at all within IRS literature as to what each of these terms exactly means; however, the fact that a League group exemption has been in existence seems clear proof that the normal relationship between state Leagues and local Leagues qualifies.

Under the contemplated consolidation, afterwards the state League entity could possibly retain in its Bylaws certain “supervisory or control” powers over local Leagues, such as the existing provisions which cover the recognition or dissolution of local Leagues. On the other hand, the state League entity would no longer have any members after the consolidation and so it is likely that this lack of membership could be interpreted to mean that it was no longer “affiliated” with the local Leagues and therefore would not be qualified as a central organization.
If the group exemption ceases to have effect as to the entire group, then it would be necessary to ensure that each of the local Leagues which are not intending to convert to §501(c)(3) status can remain exempt under §501(c)(4) on an individual basis. This should almost certainly not be an issue, as these Leagues have qualified for that status within the group exemption, and the great majority of Leagues across the country have always qualified under that Code section. However, these local Leagues will have to contact the IRS Exempt Organization Help Line, (877) 829-5500, and ask to have a “data sheet” set up in the IRS system. They must have articles of incorporation and/or bylaws, with appropriate language for a §501(c)(4) organization. But they will not actually have to provide copies of such documentation at the time of making this call.

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ii Ibid., Section 7.01.
iii Ibid., Section 7.02.
v Ibid., Section 7.03
vi Ibid., Section 4; Publication 557, Pages 8-10; and Publication 4573.