



# Can You (Should You?) Change Your IRS Status?

*Can you convince the IRS to change your tax-exempt status? Is it worth the try?*

**Q:**

We are a new nonprofit 501(c)(4) organization—a neighborhood crime watch and patrol program in New York. When we applied for incorporation, we asked for 501(c)(3) status but were given 501(c)(4) status instead.

Other New York nonprofits that serve as civilian observation patrols have 501(c)(3) status. Our organization is a bit different, as we have professional and volunteer security guards as well as a civilian observation patrol. I was told that because of the word “Security” in our organization’s name, we will have trouble gaining 501(c)(3) status. Is this true? How can I legally amend our incorporation application to attain 501(c)(3) status?

Also, what are the main financial differences between 501(c)(3)s and 501(c)(4)s? In particular, what are the differences in the way the IRS taxes unrelated business income? Any information would be extremely helpful.

*David Kohlmeier, President  
Little Neck Douglaston Security Association  
Douglaston, New York*

**A:** “Lessening the burdens of government” is a “charitable” purpose which may qualify an organization for tax exemption under Section 501(c)(3) of the Internal Revenue Code. Thus, one way to help secure a 501(c)(3) ruling is to have a good working relationship with a government unit. Such a relationship may convince the IRS that your organization’s activity would normally be the government’s burden. It’s not sufficient to perform an activity sometimes undertaken by government. Nor is it

enough for government officials to express approval of your work. You need an ongoing, cooperative relationship with some segment of government. In your case, it would be natural to form such a relationship with the police.

In contrast to 501(c)(3) “charitable organizations,” 501(c)(4)s are known as “social welfare organizations.” The IRS has never explained how it differentiates between 501(c)(3)s and 501(c)(4)s. At times it has relied on factors such as the income level of intended beneficiaries. At other times, it distinguishes the two types of organizations based on the

number of possible beneficiaries. If an organization benefits only a discrete segment of the community, the IRS will probably judge it to be a 501(c)(4) rather than a 501(c)(3) organization. For instance, many community associations

**Q&A**

**“One way to secure a 501(c)(3) ruling is to have a good working relationship with a government unit.”**

have 501(c)(4) status. In return for a fee, these associations provide special services to their members.

In addressing your questions, I’m basing my answers on the newspaper articles and other information about your organization which you enclosed with your letter. I’m assuming that you used similar information in your exemption application. Based on that material, I suspect there are several reasons why

Nonprofit World • Volume 15, Number 1 January/February 1997  
Published by the Society for Nonprofit Organizations  
6314 Odana Road, Suite 1, Madison, WI 53719 • (800) 424-7367



## Q&A

**“It might be worthwhile to reapply for 501(c)(3) status, if you can truthfully emphasize certain facts.”**

the IRS granted your organization 501(c)(4) rather than 501(c)(3) status:

1. You show no working relationship between your organization and the police or any other government unit. Remember that the expression of approval by government officials is not enough to show that an organization lessens the burdens of government.
2. Although your organization apparently patrols areas surrounding all homes in the neighborhoods, you offer many benefits only to people who pay a membership fee. This makes your organization analogous to a 501(c)(4) community association. Many 501(c)(3)s charge fees for services, but those with purposes comparable to yours are more likely to serve a broad charitable class, most of whom do not pay. Note that local governments themselves provide services, such as police protection, firefighting, and trash pick-up, to all community residents.
3. Most people who work for your organization are salaried employees. There’s no requirement that most people serving a 501(c)(3) be volunteers, but the organizations most comparable to yours, such as volunteer fire depart-

ments, are made up mostly of volunteers.

It might be worthwhile for your organization to reapply for 501(c)(3) status, if you can truthfully emphasize the following:

1. Your organization works hand-in-hand with the police.
2. You provide most of your services to all residents of your community, whether or not they pay a membership fee.
3. A large base of volunteers serves your organization.

Many organizations with names such as “Crime Stoppers” and “Neighborhood Watch” have qualified for 501(c)(3) status. I doubt that your organization’s name by itself should be a deterrent to 501(c)(3) status. If I were choosing a name, however, I would select something akin to “Crime Stoppers.”

The main advantage of 501(c)(3) over 501(c)(4) status is that 501(c)(3)s can seek tax-deductible donations. On the other hand, 501(c)(3)s are restricted in the amount of lobbying they can do, while 501(c)(4)s are not.

The IRS treats both types of organizations similarly in taxing unrelated business income. There are a few exceptions, however. Only 501(c)(3)s are tax-exempt for businesses conducted for their employees’ or members’ convenience. Also, a 501(c)(3) may rent a mailing list to another 501(c)(3) without tax on the income, while a 501(c)(4) must pay tax on its mailing list income. Generally, though, 501(c)(3) status does not provide a significant advantage over 501(c)(4) status in reducing unrelated business income tax.

*Hal Katen, Attorney and C.P.A.  
Stouffer & Ryan  
1515 Market Street, Suite 1530  
Philadelphia, Pennsylvania 19102  
215-496-9420*