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Tax-Exempt Organizations: Political Activity Restrictions and Disclosure Requirements

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Summary

Recently, significant attention has been paid to the political activities of tax-exempt organizations. In particular, the activities of IRC § 501(c)(3) charitable organizations, § 501(c)(4) social welfare organizations, § 501(c)(5) labor unions, § 501(c)(6) trade associations, and § 527 political organizations have been scrutinized.

This report discusses the limitations that the Internal Revenue Code places on political activity, including lobbying and campaign intervention, by tax-exempt organizations. It focuses on the above organizations, but also discusses the restrictions on the other types of tax-exempt organizations. The report ends with a summary of the information that tax-exempt organizations must report to the Internal Revenue Service about their political activities and whether the information must be made publicly available.

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Tax-Exempt Organizations: Political Activity Restrictions and Disclosure Requirements

There are more than thirty types of organizations that qualify for exemption from the federal income tax. Each type is described in a particular section or subsection of the Internal Revenue Code (IRC). The organizational definition in that section or subsection determines the extent to which the organization may participate in political activity, including lobbying and campaign intervention.

The majority of tax-exempt organizations are described in:

- IRC § 501(c)(3), which describes public charities and private foundations;
- IRC § 501(c)(4), which describes social welfare organizations;
- IRC § 501(c)(5), which describes labor unions;
- IRC § 501(c)(6), which describes trade associations; and
- IRC § 527, which describes political organizations.

These organizations receive the most attention with respect to their political activities. In general, the basic parameters of these organizations' ability to participate in political activity is understood from the IRC, Treasury regulations, and IRS guidance. With respect to the other types of tax-exempt organizations, the IRC restrictions on their political activities are less clear and there is almost no IRS guidance to help clarify the situation. The lack of guidance is not unexpected because it does not appear that these other organizations participate in a significant amount of political activity.

This report discusses the IRC limitations on political activity by IRC § 501(c)(3) organizations, §§ 501(c)(4), (c)(5) and (c)(6) organizations, § 527 organizations, and the other types of tax-exempt organizations. It ends with a summary of the IRC reporting and disclosure requirements.

Although this report discusses the political activity limitations in the IRC, it is important to realize that organizations must abide by any applicable election laws. For example, since campaign finance laws ban corporations from making any contribution or expenditure in connection with federal elections, an incorporated tax-exempt organization is generally prohibited from doing so.¹ For more

¹ Under 11 CFR § 114.10, qualifying incorporated IRC § 501(c)(4) organizations may make “independent expenditures” (expenditures that expressly advocate for a candidate but are made without the candidate’s cooperation) and “electioneering communications” (broadcast, cable, or satellite advertisements that refer to a clearly-identified federal candidate within sixty days of a general election or thirty days of a primary election and, if a House or Senate election, are targeted to the relevant electorate). Among other things, the organization must

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information on campaign finance laws, see CRS Report RS21571, *Campaign Finance and Prohibiting Contributions by Tax-Exempt Corporations: FEC v. Beaumont*, by L. Paige Whitaker; and CRS Issue Brief IB87020, *Campaign Finance*, by Joseph E. Cantor.

Political Activity by IRC § 501(c)(3) Organizations

Organizational Definition

The organizations described in IRC § 501(c)(3) are commonly referred to as charitable organizations. The section describes these organizations as:

organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.²

There are two types of IRC § 501(c)(3) organizations: public charities and private foundations. Public charities receive contributions from a variety of sources whereas private foundations receive contributions from limited sources. Due to fear of abuse, private foundations are subject to stricter regulation than public charities. This includes additional restrictions on their political activities, as discussed below. Examples of public charities include the Red Cross, churches, schools, hospitals, Boy Scouts, Girl Scouts, animal shelters, and Little League. Examples of private foundations include the John D. and Catherine T. MacArthur Foundation, the Ford Foundation, and the Mars Foundation.

Summary of the Definition's Restrictions on Political Activity. The organizational definition in IRC § 501(c)(3) restricts the ability of these organizations

¹ (...continued)

have the promotion of political ideas as its sole express purpose. This exception reflects the Supreme Court's decision in *Federal Election Commission v. Mass. Citizens for Life, Inc.*, 479 U.S. 238 (1986), in which the Court held that limits on election-related independent spending by certain incorporated advocacy groups were unconstitutional because the government had failed to show a compelling reason for infringing on the groups' free speech rights. The Court stated that while the government may have a compelling corruption-related interest in restricting the independent spending of incorporated businesses, it had not shown that a similar interest existed for treating incorporated nonprofit organizations differently than other nonprofit organizations. *Id.* at 263-64.

² IRC § 501(h) provides a test for measuring the amount of lobbying done by an organization. It is discussed below.

to participate in political activity in two ways: (1) they may only conduct an insubstantial amount of lobbying and (2) they may not intervene in political campaigns. Organizations that violate either restriction may lose their tax-exempt status and the eligibility to receive deductible contributions. Additionally, the organization may, either in addition or as an alternative to the loss of tax-exempt status, be required to pay an excise tax on its political or lobbying expenditures, be enjoined from making further expenditures, and receive a termination assessment of all taxes owed. The lobbying restriction and political campaign prohibition are discussed in detail below.

Legislative History of the Political Activity Restrictions. The lobbying limitation was enacted in 1934 and the political campaign prohibition was enacted in 1954. The legislative history of both provisions is sparse.

In 1919, the Treasury Department took the position that organizations “formed to disseminate controversial or partisan propaganda” were not “educational” for purposes of qualifying for tax-exempt status under the precursors to IRC § 501(c)(3).³ One consequence of this rule was that contributions to these organizations were not deductible. Several lawsuits were brought that challenged this treatment, but no clear standard emerged from the court decisions — some courts denied the deduction if the organization advocated for any type of change, whereas others looked at factors such as how controversial the advocacy was or if the organization’s actions were intended to influence legislation.⁴ In what is generally recognized as the seminal case, *Slee v. Commissioner*,⁵ the U.S. Court of Appeals for the Second Circuit used another rationale. In that decision, the court held that contributions to an organization were not deductible because it did not appear that the lobbying was limited to causes that furthered the organization’s charitable purpose.⁶

With this background, Congress enacted the lobbying limitation as part of the Revenue Act of 1934. There is very little legislative history for the provision, but it appears that Congress was concerned with organizations that lobby also being able to receive tax-deductible contributions.⁷ While discussing the provision on the Senate floor, one Member complained about the deductibility of donations that were made for “selfish” reasons and specifically mentioned an organization with which he

³ Treas. Reg. 45, Art. 517 (1919).

⁴ For a discussion of the Treasury position and these cases, see William J. Lehrfeld, *The Taxation of Ideology*, 19 CATH. U. L. REV. 50 (1969); Tommy F. Thompson, *The Availability of the Federal Educational Tax Exemption for Propaganda Organizations*, 18 U.C. DAVIS L. REV. 487 (1985); Laura B. Chisholm, *Exempt Organizations Advocacy: Matching the Rules to the Rationales*, 63 IND. L.J. 201 (1988); Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code’s Treatment of Legislative Activities*, 71 TEX. L. REV. 1269 (1993); Oliver A. Houck, *On The Limits of Charity: Lobbying, Litigation, and Electoral Politics by Charitable Organizations under the Internal Revenue Code and Related Laws*, 69 BROOK. L. REV. 1 (2003).

⁵ 42 F.2d 184 (2nd Cir. 1930).

⁶ See *id.* at 185.

⁷ See 78 CONG. REC. 5,959 (1934) (statement by Sen. Harrison).

was apparently having problems.⁸ Although this Member apparently believed the provision was too broad in that it applied to organizations without “selfish motives,”⁹ other Members argued that all contributions to organizations that lobby should be nondeductible because of the difficulty in trying to distinguish between organizations that deserve the benefit and those that do not.¹⁰ It has also been suggested that Congress enacted the provision in order to codify the *Slee* decision.¹¹ Although this may be true, it should be noted that the *Slee* test and the lobbying provision are not identical. This is because the focus of the test under *Slee* is whether the lobbying furthers the organization’s tax-exempt purpose, whereas the focus of the lobbying provision is whether the lobbying is a substantial part of the organization’s activities.

The 1934 Act had also included a provision that would have restricted the ability of charities to participate in partisan politics. However, that limitation was removed in conference, apparently because of concerns it was too broad.¹²

The political campaign prohibition was enacted as part of the Internal Revenue Code of 1954. The provision was added by Senator Lyndon Johnson as a floor amendment. Upon introducing the amendment, Senator Johnson analogized it to the lobbying limitation; however, he mischaracterized the lobbying limitation by saying that organizations that lobbied were denied tax-exempt status, as opposed to only those organizations that substantially lobbied.¹³ The legislative history contains no further discussion of the prohibition, including whether Senator Johnson’s overly-broad description of the lobbying provision and inaccurate analogy were noticed. Although Senator Johnson’s motives behind the provision are not clear from the legislative history, it has been suggested that he proposed it either as a way to get back at an organization that had supported an opponent or because he wished to offer an alternative to another Senator’s proposal that would have denied tax-exempt status to organizations making grants to organizations or individuals that were deemed to be subversive.¹⁴

Lobbying by IRC § 501(c)(3) Organizations

The organizational definition in IRC § 501(c)(3) states that “no substantial part” of an organization’s activities may be “carrying on propaganda, or otherwise attempting, to influence legislation” (i.e., lobbying).

⁸ 78 CONG. REC. 5,861 (1934) (statement by Sen. Reed).

⁹ *Id.*

¹⁰ *See* 78 CONG. REC. 5,861 and 5,959 (1934) (statements by Sens. Harrison and La Follette).

¹¹ *See e.g.*, Gen. Couns. Mem. 34289 (May 3, 1970). General Counsel Memoranda contain legal interpretations of the IRC by the IRS. They have no precedential value. They are available through such services as Lexis and Westlaw.

¹² *See* 78 CONG. REC. 7,831 (1934) (statement by Rep. Hill).

¹³ *See* 100 CONG. REC. 9,604 (1954).

¹⁴ *See* Judith E. Kindell and John Francis Reilly, *Election Year Issues*, IRS 2002 EO CPE TEXT, 448-51 (2002).

What is Lobbying? Lobbying includes activities that attempt to influence legislation by (1) contacting, or urging the public to contact, legislators about proposing, supporting, or opposing legislation and (2) advocating for or against legislation.¹⁵ Thus, it includes direct lobbying (contacting governmental officials) and grassroots lobbying (appeals to the electorate or general public). “Legislation” includes action by any legislative body and by the public through such things as referenda and initiatives.¹⁶ “Action” includes the introduction, amendment, enactment, defeat, or repeal of such things as acts, bills, and resolutions.¹⁷ It also appears to include Senate confirmation of judicial and executive branch nominations.¹⁸ An organization’s advocacy activities may be lobbying even if legislation is not actually pending.¹⁹ Furthermore, an organization may be treated as lobbying if it does such things as make a contribution or lend money on favorable terms to an entity that lobbies.

Lobbying generally does not include providing testimony in response to an official request by a legislative body.²⁰ It also does not include contacting executive, judicial, and administrative bodies on matters other than legislation.²¹ Additional examples of activities that may not be lobbying include conducting and publishing nonpartisan analysis, study, or research; discussing broad social issues, so long as specific legislation is not discussed; and contacting legislative bodies about legislation that relates to the organization’s existence or status.²²

What is “No Substantial Part”? In order to determine whether lobbying is a substantial part of an organization’s activities, the organization may elect under IRC § 501(h) to measure its lobbying expenditures against objective, numerical standards.²³ If the election is not made, the organization is subject to the “no substantial part” test, which has no bright-line standards. Most organizations do not make the election.

IRC § 501(h) election. Organizations that make the IRC § 501(h) election measure their lobbying activities against the limits in IRC § 4911. Some IRC §

¹⁵ See Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii).

¹⁶ See *id.*

¹⁷ See Gen. Couns. Mem. 39694 (Jan. 22, 1988); IRC § 4911(e)(3).

¹⁸ See IRS Notice 88-76, 1988-2 C.B. 392; Gen. Couns. Mem. 39694 (Jan. 22, 1988).

¹⁹ See *e.g.*, *Christian Echoes Nat’l Ministry Inc. v. United States*, 470 F.2d 849, 855 (10th Cir. 1972).

²⁰ See Rev. Rul. 70-449, 1970-2 C.B. 111.

²¹ See Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii).

²² See Rev. Rul. 64-195, 1964-2 C.B. 138; Gen. Couns. Mem. 36127 (Jan. 2, 1975); IRC § 4945(e); Treas. Reg. § 53.4945-2(d).

²³ IRC § 501(h) was enacted as part of the Tax Reform Act of 1976, P.L. 94-455.

501(c)(3) organizations, including churches and private foundations, are not allowed to make the election.²⁴

The IRC § 501(h) election has two effects. First, it imposes an excise tax on organizations whose lobbying expenditures exceed the limits in IRC § 4911. IRC § 4911 sets limits for total lobbying expenditures and for grass roots expenditures. In order not to be taxed for excessive lobbying, an organization may not spend more than 20% of its first \$500,000 of expenditures on lobbying, nor more than 15% of its second \$500,000 of expenditures, nor more than 10% of its third \$500,000 of expenditures, nor more than 5% of its remaining expenditures, and no more than \$1 million on lobbying in the year. In order not to be taxed for excessive grass roots lobbying, the organization may not spend more than 5% of its first \$500,000 of expenditures on grass roots lobbying, nor more than 3.75% of its second \$500,000 of expenditures, nor more than 2.5% of its third \$500,000 of expenditures, nor more than 1.25% of its remaining expenditures, and no more than \$250,000 on grass roots lobbying in the year. If an organization's lobbying expenditures exceed these limits, IRC § 4911 imposes an excise tax equal to 25% of the excess.

Second, the IRC § 501(h) election provides a safe harbor so that organizations that do not exceed that amount will not lose their IRC § 501(c)(3) status due to substantial lobbying. Specifically, an organization will not lose its exempt status so long as its lobbying expenditures do not exceed 150% of the IRC § 4911 limitations over a four year period. Thus, depending on its activities in prior years, an organization could conduct lobbying in the current year that is significant enough to be subject to tax, but not lose its tax-exempt status.

Non-Electing Organizations. For organizations that do not make the IRC § 501(h) election and those that cannot (e.g., private foundations and churches), the determination as to whether they have conducted more than an insubstantial amount of lobbying is dependent on the facts and circumstances of each case. Case law suggests that “no substantial part” is between 5% and 20% of the organization's expenditures.²⁵ However, there is no bright-line test and the percentage of expenditures spent on lobbying is not determinative.²⁶ Rather, the determination is made by examining the lobbying in the broad context of the organization's purpose and activities, which requires looking at such things as how important lobbying is to

²⁴ Some churches lobbied not to be eligible for the election because they were concerned that their inclusion would be interpreted as congressional approval of *Christian Echoes Nat'l Ministry, Inc. v. United States*, 470 F.2d 849 (10th Cir. 1972), in which the U.S. Court of Appeals for the Tenth Circuit held that the lobbying limitation did not violate a church's rights under the First Amendment. The legislative history of the election provision explicitly states that its enactment does not indicate congressional approval or disapproval of the *Christian Echoes* decision. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, JCS-33-76, at 416 (1976).

²⁵ See *Seasongood v. Comm'r*, 227 F.2d 907, 912 (6th Cir. 1955); *Haswell v. United States*, 500 F.2d 1133, 1146-47 (Ct. Cl. 1974).

²⁶ See *Christian Echoes Nat'l Ministry, Inc. v. United States*, 470 F.2d 849, 855 (10th Cir. 1972); *Haswell*, 205 Ct. Cl. at 1142; *Krohn v. United States*, 246 F. Supp. 341, 347-48 (D. Colo. 1965); Gen. Couns. Mem. 36148 (Jan. 28, 1975).

the organization's purpose, the amount of time devoted to lobbying as compared with other activities, and the extent to which the organization is continuously involved in lobbying.²⁷

Unlike electing organizations, non-electing public charities are only subject to an excise tax on their lobbying expenditures if they lose their exempt status because of substantial lobbying.²⁸ The tax equals 5% of the organization's lobbying expenditures, and the same tax may also be imposed on the organization's manager. Some organizations, including churches, are not subject to the tax.

Private foundations, on the other hand, must generally pay an excise tax on any lobbying expenditures they make.²⁹ Thus, although private foundations may conduct an insubstantial amount of lobbying, there is a disincentive for them to do so. The tax equals 10% of the expenditures. Note that unlike the case with electing public charities, any amount spent by the private foundation on lobbying is subject to tax. Additionally, a foundation manager who agrees to the expenditure may individually be subject to a tax equal to 2.5% of the expenditure, limited to \$5,000. If the foundation fails to timely correct the expenditure, it is subject to an additional tax equal to 100% of the expenditure and the manager may be subject to an additional tax equal to 50% of the expenditure, limited to \$10,000.

Regan v. Taxation With Representation of Washington. In 1983, the Supreme Court ruled in *Regan v. Taxation With Representation of Washington* that the lobbying limitation is constitutional.³⁰ In that case, the IRS denied the application of Taxation With Representation of Washington (TWR) for IRC § 501(c)(3) status because a substantial amount of the group's activities would be lobbying. TWR argued that the lobbying limitation violated its right to freedom of speech under the First Amendment. The group also argued that it was being denied equal protection under the Fifth Amendment because IRC § 501(c)(19) veterans' organizations were allowed to lobby substantially and still qualify for tax-exempt status and to receive tax-deductible contributions.

The Supreme Court rejected both claims. With respect to the First Amendment, the Court found that Congress had not prevented TWR from speaking, but had simply chosen not to subsidize it by means of the tax exemption and tax-deductible contributions.³¹ The court also noted that TWR could qualify for exemption under IRC § 501(c)(4) and receive deductible contributions for its non-lobbying activities

²⁷ See *Christian Echoes*, 470 F.2d at 855-86; *Haswell*, 205 Ct. Cl. at 1145; *Krohn*, 246 F. Supp. at 348-49.

²⁸ IRC § 4912. This section was enacted as part of the Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203).

²⁹ IRC § 4945. This section was enacted as part of the Tax Reform Act of 1969 (P.L. 91-172).

³⁰ 461 U.S. 540 (1983).

³¹ See *id.* at 545-46.

by setting up a separate IRC § 501(c)(3) organization.³² With respect to the Fifth Amendment, the Court stated that the test to determine whether the classification was constitutionally permissible was whether it bore a rational relationship to a legitimate governmental purpose.³³ Noting that legislatures have broad discretion when it comes to making classifications for tax purposes, the Court found that it was not irrational for Congress to decide not to extend the taxpayer-funded benefit of unlimited lobbying to charities because of concerns they may lobby for their members' benefit.³⁴ The Court also stated that distinguishing charities from veterans organizations was permissible because the United States "has a longstanding policy of compensating veterans for their past contributions by providing them with numerous advantages."³⁵

Political Campaign Activity by IRC § 501(c)(3) Organizations

The organizational definition in IRC § 501(c)(3) prohibits these organizations from "participating in, or intervening in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." The IRC does not further elaborate on the prohibition. Treasury regulations define candidate as "an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local."³⁶ As to what types of activities are prohibited, the regulations add little besides specifying that they include "the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such a candidate."³⁷

Thus, the statute and regulations do not offer much insight as to what activities are prohibited. Clearly, IRC § 501(c)(3) organizations may not do such things as make statements that endorse or oppose a candidate, publish or distribute campaign literature, or make any type of contribution, monetary or otherwise, to a political campaign. On the other hand, IRC § 501(c)(3) organizations are allowed to conduct activities that are not related to elections, such as issue advocacy, lobbying for or against legislation, and supporting or opposing the appointment of individuals to nonelective offices.

Additionally, IRC § 501(c)(3) organizations are allowed to conduct certain election-related activities so long as the activities are non-partisan and do not indicate a preference for any candidate. Whether such an activity is campaign intervention depends on the facts and circumstances of each case. The following examples show some of the ways in which an activity might be biased. As will be seen, some biases

³² *See id.* at 544.

³³ *See id.* at 547.

³⁴ *See id.* at 547 and 550.

³⁵ *Id.* at 550-51.

³⁶ Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii).

³⁷ *Id.*

can be subtle and it is not necessary that the organization expressly mention a candidate by name.

Voter Guides. IRC § 501(c)(3) organizations may create and/or distribute voter guides and similar materials that do not indicate a preference towards any candidate. The guide must be unbiased in form, content, and distribution. There are numerous ways in which a guide may show a bias, and the determination will depend on the specific facts and circumstances of each case. For example, a guide could display a bias by not including all candidates on an equal basis. Another way a guide could be biased is by rating candidates, such as evaluating candidates and supporting a slate of the best-qualified candidates, even if the criteria are nonpartisan (e.g., based on professional qualifications).³⁸ A voter guide could also indicate a bias by comparing the organization's position on issues with those of the candidates.³⁹ A more subtle way in which a guide may show bias is by only covering issues that are important to the organization, as opposed to covering a range of issues of interest to the general public.⁴⁰

Some guides consist of candidate responses to questions provided by the organization. Factors that tend to show these guides are candidate-neutral include:

- the questions and descriptions of the issues are clear and unbiased,
- the questions provided to the candidates are identical to those included in the guide,
- the candidates' answers have not been edited,
- the guide puts the questions and appropriate answers in close proximity to each other,
- the candidates are given a reasonable amount of time to respond to the questions, and
- if the candidates are given limited choices for an answer to a question (e.g., yes/no, support/oppose), they are given a reasonable opportunity to explain their positions.⁴¹

It is important to realize that the above two paragraphs are just examples of how a guide could be biased. The determination of whether a guide is a campaign intervention depends on the facts and circumstances of that case. Thus, it is possible that a guide that is neutral according to the above paragraphs could still be treated as campaign intervention because it indicates a preference for a candidate in some other way. On the other hand, a guide is not necessarily biased just because it has or lacks a characteristic from the above examples. Other factors that may be important in a specific factual situation include the timing of the guide's distribution and to whom it is distributed. For example, the IRS ruled that an IRC § 501(c)(3) organization could include in the edition of its monthly newsletter after the close of each Congress a compilation of the Members' voting records on issues important to the organization

³⁸ See Rev. Rul. 67-71, 1967-1 C.B. 125.

³⁹ See IRS FS-2006-17 (Feb. 2006).

⁴⁰ See Rev. Rul. 78-248, 1978-1 C.B. 154.

⁴¹ See IRS FS-2006-17 (Feb. 2006); Rev. Rul. 78-248, 1978-1 C.B. 154.

and the organization's position on those issues.⁴² The newsletter was sent to the usual small number of subscribers and not targeted to areas where elections are occurring. In this specific situation, the IRS stated that the publication was permissible because it was not timed to an election or broadly distributed.

Conducting Public Forums. IRC § 501(c)(3) organizations may conduct unbiased and nonpartisan public forums where candidates speak or debate. The factors that tend to show a public forum is unbiased and nonpartisan include:

- all legally qualified candidates are invited,
- the questions are prepared and presented by a nonpartisan independent panel,
- the topics and questions cover a broad range of issues,
- all candidates receive an equal opportunity to present their views,
- the moderator does not comment on the questions or imply approval or disapproval of the candidates, and
- the moderator explicitly states that the views expressed are not those of the organization and that the organization does not support or oppose any candidate.⁴³

The presence of all the above factors does not necessarily mean that the forum is permissible, and the absence of some does not necessarily mean that the forum is impermissible. Whether an organization is found to have participated in political campaign activity will depend on the facts and circumstances of that case.

Inviting Candidates to Speak. An IRC § 501(c)(3) organization may invite a candidate to speak at its functions without it being prohibited campaign activity. The organization must provide an equal opportunity to speak at similar events to the other candidates, the organization must make clear that it is not supporting or opposing the candidate, and no fund-raising may occur.⁴⁴ IRC § 501(c)(3) organizations may also invite candidates to speak in their non-candidate capacity.⁴⁵ The individual may only speak in his or her non-candidate capacity and no reference to the election may be made.

Voter Registration. IRC § 501(c)(3) organizations may conduct nonpartisan voter registration and get-out-the-vote drives. Again, the activities may not indicate a preference for any candidate or party. Factors that may indicate these activities are neutral include:

- candidates are named or depicted on an equal basis,
- no political party is named except for purposes of identifying the party affiliation of each candidate,

⁴² See Rev. Rul. 80-282, 1980-2 C.B. 178.

⁴³ See Rev. Rul. 86-95, 1986-2 C.B. 73.

⁴⁴ See IRS FS-2006-17 (Feb. 2006).

⁴⁵ See *id.*

- the activity is limited to urging acts such as voting and registering and to describing the hours and places of registration and voting, and
- all registration and get-out-the-vote drive services are made available without regard to the voter's political preference.⁴⁶

Issue Advocacy. IRC § 501(c)(3) organizations may take positions on policy and legislative issues, although, as discussed above, there are restrictions on the amount of lobbying an organization may do. Because there is no rule that political campaign activity only occurs when an organization expressly advocates for or against a candidate, the line between issue advocacy and political campaign activity can be difficult to discern. Key factors that indicate an issue advocacy communication is not political campaign intervention include:

- the communication does not identify any candidates for a given public office,
- the communication does not express approval or disapproval for any candidate's positions and/or actions,
- the communication is not delivered close in time to an election,
- the communication does not refer to voting or an election,
- the issue addressed in the communication has not been raised as an issue distinguishing the candidates,
- the communication is part of an ongoing series by the organization on the same issue and the series is not timed to an election, and
- the communication's timing and identification of the candidate are related to a non-electoral event (e.g., a scheduled vote on specific legislation by an officeholder who also happens to be a candidate for public office).⁴⁷

Once again, whether a specific communication violates the political campaign prohibition depends on the facts and circumstances of that case. Thus, a communication that has all of the above factors could still be treated as campaign intervention if it shows bias in some other way.

Selling Mailing Lists and Other Business Activities. Under certain circumstances, IRC § 501(c)(3) organizations may sell or rent goods, services, and facilities to political campaigns. This includes selling and renting mailing lists and accepting paid political advertising. Factors that indicate the activity is not biased towards any candidate or party include:

- the selling or renting activity is an ongoing business activity of the organization;
- the goods, services, and facilities are also available to the general public;
- the fees charged are the organization's customary and usual rates; and

⁴⁶ See 2002 EO CPE TEXT, *supra* note 14, at 379.

⁴⁷ See IRS FS-2006-17 (Feb. 2006); 2002 EO CPE TEXT, *supra* note 14, at 376-77.

- the goods, services, or facilities are available to all the candidates on an equal basis.⁴⁸

Website Links. An IRC § 501(c)(3) organization could engage in political campaign activity by linking its website to another website that has content showing a preference for a candidate. It does not matter that the organization cannot control the other site's content. Whether the linking is political campaign intervention will depend on the facts and circumstances of each case. The factors that the IRS will look at include the context of the link on the organization's website, whether all candidates are presented, whether the linking serves the organization's exempt purpose, and the directness between the organization's website and the page at the other site with the biased material.⁴⁹

Activities of the Organization's Leaders and Members. Members, managers, leaders, and directors of IRC § 501(c)(3) organizations may participate in political campaign activity in their private capacity. The organization can not support the activity in any way.⁵⁰ For example, these individuals may not express political views in the organization's publications or at its functions, and the organization may not pay expenses incurred by the individual in making the political statement. Individuals may be identified as being associated with an organization, but there should be no indication that their views represent the organization.

Tax on Expenditures for Political Campaign Activity. Under IRC § 4955, an IRC § 501(c)(3) organization that makes an expenditure on political campaign activity may be subject to an excise tax.⁵¹ If the expenditure is small and the violation is unintentional, the tax may be imposed as an alternative to the organization losing its tax-exempt status.⁵² The tax equals 10% of the expenditure, and a tax equal to 2.5% of the expenditure, limited to \$5,000, may also be imposed on the organization's manager. If the expenditure is not corrected (i.e., recovered and safeguards established to prevent future expenditures) in a timely manner, then the organization is subject to an additional tax equal to 100% of the expenditure, and the manager may be subject to an additional tax equal to 50% of the expenditure, limited to \$10,000.

A similar tax is imposed on private foundations under IRC § 4945. If a tax is assessed on a private foundation under IRC § 4955, then no tax may be assessed under IRC § 4945.

⁴⁸ See IRS FS-2006-17 (Feb. 2006); 2002 EO CPE TEXT, *supra* note 14, at 383-84.

⁴⁹ See IRS FS-2006-17 (Feb. 2006).

⁵⁰ See IRS FS-2006-17 (Feb. 2006); 2002 EO CPE Text, *supra* note 14, at 363-65; Gen. Couns Mem. 34523 (June 11, 1971); Gen. Couns. Mem. 39414 (Sept. 25, 1985).

⁵¹ This section was enacted as part of the Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203).

⁵² See H.R. Rep. No. 100-391, at 1623-24 (1987).

Tax Under IRC § 527(f)

All IRC § 501(c) organizations are subject to tax if they make an expenditure for an IRC § 527 exempt function. An IRC § 527 exempt function is influencing the selection, nomination, election, or appointment of an individual to a federal, state, or local public office, to an office in a political organization, or as a presidential or vice-presidential elector. This issue is discussed further in the “IRC § 527 Exempt Functions” section, below.

Political Activity by IRC §§ 501(c)(4), (c)(5), and (c)(6) Organizations

Organizational Definitions

IRC § 501(c)(4). The organizations described in IRC § 501(c)(4) are commonly referred to as social welfare organizations. The section describes these organizations as:

[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. [This paragraph] shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Treasury regulations clarify that “[a]n organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.”⁵³ Examples of IRC § 501(c)(4) organizations include the National Rifle Association and the Sierra Club.⁵⁴

IRC § 501(c)(5). IRC § 501(c)(5) organizations are described as “labor, agricultural, or horticultural organizations.” Most of these organizations are labor unions.

⁵³ Treas. Reg. § 1.501(c)(4)-1(a)(2).

⁵⁴ The purposes described in sections IRC §§ 501(c)(3) and (c)(4) overlap, so that an organization may be able to qualify under either section. An IRC § 501(c)(3) organization is eligible to receive tax-deductible contributions, while an IRC § 501(c)(4) organization is not, but an IRC § 501(c)(3) organization is more limited in the amount and types of political activity it may do. Thus, an organization that could qualify under either section will generally choose based on which is more important: receiving tax-deductible contributions or participating in political activity. With the exception of churches and related organizations, an organization that loses its IRC § 501(c)(3) status because of political campaign activity or substantial lobbying may not then seek recognition as an IRC § 501(c)(4) organization. IRC § 504.

IRC § 501(c)(6). The organizations described in IRC § 501(c)(6) are generally thought of as trade associations. The section describes these organizations as:

[b]usiness leagues, chambers of commerce, real estate boards, boards of trade, or professional football leagues . . . not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Examples of IRC § 501(c)(6) organizations include the Chamber of Commerce, Jaycees, American Bar Association, American Medical Association, and National Association of Manufacturers.

Lobbying by IRC §§ 501(c)(4), (c)(5), and (c)(6) Organizations

The organizational definitions in IRC §§ 501(c)(4), (c)(5), and (c)(6) do not contain any explicit limitations on lobbying. The organizations described in these three sections may participate in an unrestricted amount of lobbying so long as the lobbying is related to the organization's exempt purpose. In fact, organizations whose sole activity is lobbying may be recognized under these sections so long as they serve the appropriate tax-exempt purpose.⁵⁵ For example, a business association whose only activity is lobbying for and against legislation according to its members' interests may qualify for IRC § 501(c)(6) status.⁵⁶

Dues. Dues to labor unions and trade associations are potentially deductible under IRC § 162. However, if an organization conducts lobbying activities, IRC § 162(e) disallows a deduction for the portion of dues that represents lobbying expenditures. In general, the organization must either notify its members of the amount that is nondeductible or pay a tax on its lobbying expenditures.⁵⁷

Lobbying Disclosure Act. Section 18 of the Lobbying Disclosure Act of 1995 (P.L. 104-65) prohibits organizations described in IRC § 501(c)(4) from receiving federal grants, loans, or other awards if they engage in lobbying activities, even if they conduct the lobbying with their own funds. As originally passed, section 18 also applied to IRC § 501(c)(4) organizations that received government contracts, but the section was amended by P.L. 104-99 to delete that restriction. The Lobbying Disclosure Act imposes registration and disclosure requirements on any organizations that have paid lobbyists whose lobbying activities exceed certain time and monetary limits. For more information, see CRS Report 96-809A, *Lobbying Regulations on Non-Profit Organizations*, by Jack H. Maskell.

⁵⁵ See Rev. Rul. 61-177, 1961-1 C.B. 117; Rev. Rul. 71-530, 1971-2 C.B. 237.

⁵⁶ See Rev. Rul. 61-177, 1961-1 C.B. 117.

⁵⁷ See IRC § 6033(e).

Political Campaign Activity by IRC §§ 501(c)(4), (c)(5), and (c)(6) Organizations

The organizational definitions in IRC §§ 501(c)(4), (c)(5), and (c)(6) do not contain any explicit restrictions on political campaign activity. These organizations may engage in political campaign activity so long as it is consistent with the organization's exempt purpose. However, unlike the case with lobbying, the organizational definitions contain an implicit restriction on the amount of political campaign activity these organizations may do. Specifically, participating in political campaign activity cannot be the organization's primary activity.⁵⁸

Tax Under IRC § 527(f)

All IRC § 501(c) organizations are subject to tax if they make an expenditure for an IRC § 527 exempt function. An IRC § 527 exempt function is influencing the selection, nomination, election, or appointment of an individual to a federal, state, or local public office, to an office in a political organization, or as a presidential or vice-presidential elector. This issue is discussed further in the "IRC § 527 Exempt Functions" section, below.

Political Activity by IRC § 527 Organizations

Organizational Definition

The organizations described in IRC § 527 are political organizations or funds organized and operated primarily for accepting contributions and/or making expenditures for an exempt function. IRC § 527 defines an exempt function as:

influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

IRC § 527 encompasses every kind of political committee, including a candidate committee, a political party, and a political action committee set up by a union, a corporation or a group of politically interested citizens. In recent years, the term "527 organization" has been used to describe certain groups that intend to influence federal elections in ways that may be outside the scope of federal election law; however, the tax definition of the term is not limited to such organizations.

Legislative History of IRC § 527. Prior to 1975, the IRC was silent as to the tax treatment of organizations whose primary purpose is influencing elections. The IRS did not generally require these organizations to file tax returns, apparently

⁵⁸ See Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii); Gen. Couns. Mem. 34233 (Dec. 30, 1969).

because the IRS treated contributions to political organizations as nontaxable gifts.⁵⁹ By the early 1970s, it became apparent that these organizations had sources of income besides contributions, such as investment income and gain from the sale of donated appreciated property. In 1973, the IRS announced it would begin requiring political committees and parties with investment and other types of income to file tax returns and pay tax.⁶⁰

Congress responded in 1975 by enacting IRC § 527,⁶¹ which generally grants tax-exempt status to political organizations, as discussed below. The 1975 version of the section is similar to the version that currently exists, with the exception of the reporting requirements added in 2000. Prior to the 2000 amendments, IRC § 527 organizations only had contact with the IRS if they were required to file a tax return because they had taxable income. The lack of reporting requirements may have been because political organizations were generally thought to be candidate funds and political parties and committees (i.e, the same types of entities that, when involved in federal elections, are regulated by the Federal Election Campaign Act of 1971 (FECA) and required to report to the Federal Election Commission (FEC)).

By 2000, as an increasing number of groups known as “stealth PACs” spent money on elections, it became clear that not all IRC § 527 political organizations were being regulated under FECA. Stealth PACs were organizations designed to qualify as political organizations under IRC § 527 without having to report under FECA to the FEC. It appears the reason these organizations began growing in number during the late 1990s was because the fact that organizations could qualify under IRC § 527 without reporting to the FEC was largely unnoticed until 1996, which was when the IRS began issuing guidance on the types of activities that qualify as IRC § 527 exempt functions.⁶²

In response to the issue of stealth PACs, Congress amended IRC § 527 in 2000 to generally require that most organizations that do not report to the FEC report to the IRS and that the information be available to the public.⁶³ In 2002, Congress made changes to some of these provisions in order to, among other things, remove duplicative reporting requirements.⁶⁴

⁵⁹ See IRS Notice of Opportunity to Submit Written Comments and to Request Public Hearing with respect to the Tax Treatment of Contributions of Appreciated Property to Committees of Political Parties, 37 F.R. 22427-28 (Oct. 19, 1972).

⁶⁰ IRS Announcement 73-84, 1973-33 I.R.B. 18.

⁶¹ P.L. 93-625.

⁶² See Priv. Ltr. Rul. 9652026 (Oct. 1, 1996); Priv. Ltr. Rul. 9725036 (Mar. 24, 1997); Priv. Ltr. Rul. 9808037 (Nov. 21, 1997); Priv. Ltr. Rul. 199925051 (Mar. 29, 1999).

⁶³ P.L. 106-230.

⁶⁴ P.L. 107-276.

Tax Treatment of IRC § 527 Organizations

IRC § 527 organizations are not subject to tax on their “exempt function income.” This income is the amounts received from certain sources that are then segregated to be used for an exempt function. These sources are:

- contributions of money or other property;
- membership dues, fees, or assessments;
- proceeds, which are not received in the ordinary course of business, from political fund-raising and entertainment events or from the sale of campaign materials; and
- proceeds from conducting a bingo game.

IRC § 527 organizations are subject to tax on income from any other sources and on the income from the listed sources if the funds are not properly segregated or used for an exempt function. The tax rate is generally the highest corporate income tax rate, but the income of the principal campaign committee of a congressional candidate is taxed using the graduated corporate tax rate schedule (this is not true for campaign committees of candidates for state or local office). What types of activities are “exempt functions” is discussed in the “IRC § 527 Exempt Functions” section, below.

Nonexempt Function Activities

IRC § 527 organizations may engage in nonexempt function activities so long as these are not an organization’s primary activities. Thus, these organizations may do such things as sponsor nonpartisan education workshops, pay an incumbent’s office expenses, lobby, carry on social activities unrelated to its exempt function, and provide services to other entities.⁶⁵ However, as mentioned above, IRC § 527 organizations are only exempt from tax to the extent their nontaxable income is segregated to be used for an exempt function.⁶⁶ If an organization spends more than an insubstantial amount on a nonexempt function, the organization will be subject to tax on the amount in the segregated fund.⁶⁷ There is no definition of “insubstantial,” although the IRS has indicated that the determination is made using principles similar to those used in determining whether a non-electing public charity

⁶⁵ See Treas. Reg. § 1.527-2(a)(3); Gen. Couns. Mem. 39178 (March 6, 1984).

⁶⁶ An exempt function under IRC § 527 is the influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

⁶⁷ See Treas. Reg. § 1.527-2(b)(1). Expenditures for an illegal activity or that benefit the organization may be taxable to the organization, regardless of whether they are substantial. See Treas. Reg. § 1.527-5(a).

has violated the lobbying limitation (discussed above).⁶⁸ Thus, although these organizations may conduct nonexempt function activities, the activities may increase their tax liability.

Political Activity by Other Types of Tax-Exempt Organizations

While the majority of tax-exempt organizations fall into one of the types discussed above, the IRC describes numerous other types of organizations. The limitations the IRC places on the ability of these organizations to participate in political activity is less clear than it is for IRC §§ 501(c)(3), 501(c)(4), 501(c)(5), 501(c)(6), and 527 organizations. Furthermore, for most of these other organizations, there is no IRS guidance on the topic. This may be because the need for guidance has not arisen due to the fact that there are not as many of these organizations and they do not appear to participate in political activities to the same extent as IRC §§ 501(c)(3), 501(c)(4), 501(c)(5), 501(c)(6), and 527 organizations.

These other types of organizations fall into three categories: (1) those that appear to be prohibited from participating in most, if not all, types of political activity; (2) those that may participate in political activity but are limited in the amount they may spend; and (3) those that appear to be treated like IRC §§ 501(c)(4), (c)(5), and (c)(6) organizations.

The first category includes the tax-exempt organizations that are trusts whose funds must be dedicated to their exempt purpose. These organizations are:

- IRC § 501(c)(17) supplemental unemployment benefit trusts,
- IRC § 501(c)(18) pre-June 25, 1959, employee funded pension trusts,
- IRC § 501(c)(21) black lung benefit trusts,
- IRC § 501(c)(22) multi-employer pension plan trusts,
- IRC § 501(c)(24) ERISA trusts for certain terminated plans, and
- IRC § 501(c)(28) National Railroad Retirement Investment Trust.

Due to the restriction on what these organizations may use their funds for, it appears these organizations are generally unable to participate in political activities. It has been suggested that these organizations may lobby for limited purposes, such as on legislation that affects their existence or status.⁶⁹

The first category also appears to include the organizations that the IRS has indicated, in unofficial guidance, may not participate in political activities “because the subparagraph in which they are described limits them to an exclusive purpose (for example, IRC 501(c)(2) title holding companies, IRC 501(c)(20) group legal services

⁶⁸ See 2002 EO CPE TEXT, *supra* note 14, at 411.

⁶⁹ See Webster & Abegg, 613-3rd T.M., *Lobbying and Political Expenditures*, at A-89.

plans).”⁷⁰ It could be argued that this rationale is suspect because IRC § 501(c)(3) requires those organizations be organized and operated “exclusively” for an exempt purpose, but the IRS has interpreted the term to mean “primarily” in this context,⁷¹ and they may participate in some types of political activity. Nonetheless, this rationale could preclude the following organizations from being able to participate in political activity:

- IRC § 501(c)(2) title-holding corporations,
- IRC § 501(c)(20) group legal service plans,⁷²
- IRC § 501(c)(25) multi-parent real property title-holding companies,
- IRC § 501(c)(26) state-sponsored organizations providing health coverage to high risk individuals, and
- IRC § 501(c)(27) state-sponsored workers’ compensation reinsurance organizations.

Additionally, this rationale could prohibit IRC § 501(c)(10) domestic fraternal societies from participating in political activities because their net earnings must be devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes. To the extent that any of these organizations are precluded from participating in political activities, there could still be exceptions for such things as lobbying for legislation that affects the organization’s existence or status.⁷³

The second category — organizations that may participate in political activities, but are limited in how much they could spend — includes IRC § 528 homeowners’ associations. IRC § 528 requires that at least 90% of the organization’s expenditures be for “the acquisition, construction, management, maintenance, and care of association property, and in the case of a time share association, for activities provided to or on behalf of members of the association.”

The third category consists of the organizations that appear to be treated in the same manner as IRC §§ 501(c)(4), (c)(5), and (c)(6) organizations. It appears that they are not limited by the tax laws with respect to their ability to participate in lobbying and political campaign activity so long as such activity is consistent with the organization’s tax-exempt purpose. These organizations are:

- IRC § 501(c)(1) corporations organized by act of Congress;
- IRC § 501(c)(7) social and recreational clubs;⁷⁴
- IRC § 501(c)(8) fraternal benefit societies and associations;⁷⁵
- IRC § 501(c)(9) VEBAs (Voluntary employees’ beneficiary associations providing the payment of certain employee benefits);

⁷⁰ 2002 EO CPE TEXT, *supra* note 14, at 434.

⁷¹ See Treas. Reg. § 1.501(c)(3)-1(c)(1).

⁷² IRC § 501(c)(20) expired in 1992.

⁷³ See Webster & Abegg, 613-3rd T.M., *Lobbying and Political Expenditures*, at A-89.

⁷⁴ See Rev. Rul. 68-266, 1968-1 C.B. 270.

⁷⁵ See Priv. Ltr. Rul. 8342100 (July 20, 1983); Priv. Ltr. Rul. 8852037 (Oct. 4, 1988)

- IRC § 501(c)(11) teachers' retirement fund associations;
- IRC § 501(c)(12) benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone, electric, and water companies;
- IRC § 501(c)(13) cemetery companies;
- IRC § 501(c)(14) credit unions;
- IRC § 501(c)(15) small mutual insurance companies;
- IRC § 501(c)(16) cooperatives to finance crop operations;
- IRC § 501(c)(19) veterans' groups;⁷⁶
- IRC § 501(c)(23) veterans' organization established before 1880;
- IRC § 501(d) religious and apostolic organizations with common or communal treasury;
- IRC § 521 farmers' cooperatives; and
- IRC § 526 shipowners' protection and indemnity associations.

Tax Under IRC § 527(f)

All IRC § 501(c) organizations are subject to tax if they make an expenditure for an IRC § 527 exempt function. An IRC § 527 exempt function is the influencing the selection, nomination, election, or appointment of an individual to a federal, state, or local public office, to an office in a political organization, or as a presidential or vice-presidential elector. This issue is discussed further in the "IRC § 527 Exempt Functions" section, below.

IRC § 527 Exempt Functions

Determining whether an activity is an IRC § 527 exempt function is important for IRC § 527 political organizations and IRC § 501(c) organizations. As discussed above, IRC § 527 organizations must primarily engage in IRC § 527 exempt function activities and are subject to tax on income not used for these activities.

IRC § 501(c) organizations, on the other hand, are subject to tax if they make an expenditure for an IRC § 527 exempt function.⁷⁷ The organization is taxed at the highest corporate rate on the lesser of the organization's net investment income or its total amount of exempt function expenditures. The tax applies if the organization makes the expenditure directly or through another organization (e.g., through an IRC § 527 political organization). However, IRC § 501(c) organizations may set up a separate segregated fund under IRC § 527(f)(3). Assuming the fund is set up and administered properly, it will be treated as an IRC § 527 political organization and the IRC § 501(c) organization will not be subject to tax. However, as discussed below in the "Related Organizations" section, an IRC § 501(c) organization may not

⁷⁶ See *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 546 (1983); Priv. Ltr. Rul. 7904064 (Oct. 25, 1978).

⁷⁷ IRC § 527(f).

set up a separate segregated fund to accomplish activities the organization may not do.⁷⁸

IRC § 527 defines an exempt function as

influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

“Public office” may include federal judgeships.⁷⁹

What are IRC § 527 Exempt Functions?

Whether an activity is an IRC § 527 exempt function depends on the facts and circumstances of each case. IRC § 527 exempt functions include making expenditures for activities directly and indirectly related to supporting an exempt function. Direct expenses include campaign expenditures for such things as travel and meals, voice and speech lessons, attending testimonial dinners, election-night parties, and reasonable cash awards to campaign workers.⁸⁰ Indirect expenses are for activities that are necessary to support the organization, including the costs of solicitations, overhead, record keeping, and constructing and operating the organization’s headquarters.⁸¹ Exempt function expenditures also include expenditures for activities engaged in between election cycles, such as fund-raising and administrative activities, if directly related to the next election.⁸² Another example is amounts spent to hold seminars and conferences that are intended to generate support for candidates that share political philosophies with the organization.⁸³

Examples of expenditures that are not for an IRC § 527 exempt function include those to purchase periodicals to keep an incumbent informed on national and local issues expenses incurred by an incumbent’s staff in connection with work on legislative issues, and excess campaign funds transferred to the office holder’s office expense account.⁸⁴ Additionally, expenditures for the candidate’s personal use are not for an exempt function.⁸⁵

⁷⁸ See Treas. Reg. § 1.527-6(g).

⁷⁹ See Announcement 88-114, 1988-37 I.R.B. 26; Gen. Couns. Mem. 39694 (Jan. 22, 1988).

⁸⁰ See Treas. Reg. § 1.527-2(c)(1) and (5); Rev. Rul. 87-119, 1987-2 C.B. 151; 2002 EO CPE Text, *supra* note 14, at 398-99.

⁸¹ See Treas. Reg. § 1.527-2(c)(2); Gen. Couns. Mem. 39178 (Mar. 6, 1984).

⁸² See Treas. Reg. § 1.527-2(c)(1).

⁸³ See Treas. Reg. § 1.527-2(c)(5)(viii).

⁸⁴ See Treas. Reg. §§ 1.527-2(c) and 1.527-5(c); Rev. Rul. 87-119, 1987-2 C.B. 151.

⁸⁵ See Treas. Reg. § 1.527-5.

Expenditures for an issue advocacy communication may be exempt function expenditures if the communication crosses the line from being issue advocacy to attempting to influence an election or other selection process. The determination depends on the facts and circumstances of each case. Factors that tend to show an expenditure for an issue advocacy communication is actually for an IRC § 527 exempt function include:

- the communication identifies a candidate for public office,
- the communication identifies the candidate's position on the subject of the communication,
- the candidate's position has been raised (either by the communication or in other public communications) to distinguish him or her from other candidates,
- the communication is timed to coincide with an electoral campaign,
- the communication is targeted at voters in a particular election, and
- the communication is not part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.⁸⁶

Factors that tend to show such an expenditure is not for an IRC § 527 exempt function include:

- the absence of one or more of the above factors,
- the communication identifies specific legislation or an event outside the organization's control that the organization hopes to influence,
- the communication's timing coincides with a specific event outside the organization's control that it hopes to influence,
- the candidate is identified solely as a government official who is in a position to act on the issue in connection with a specific event (e.g., will vote on the legislation), and
- the candidate is identified solely in a list of the legislation's key sponsors.⁸⁷

Finally, illegal activities are not exempt function activities.⁸⁸ Thus, the making of expenditures in violation of election laws is not an exempt function activity.

Exceptions for Certain Expenditures Made by IRC § 501(c) Organizations

In general, an IRC § 527 exempt function means the same thing with respect to IRC § 527 organizations and IRC § 501(c) organizations. There are, however, several exceptions. Treasury regulations specify that there are several instances where an exempt function expenditure made by an IRC § 501(c) organization will not

⁸⁶ See Rev. Rul. 2004-6, 2004-1 C.B. 328.

⁸⁷ See *id.*

⁸⁸ See Treas. Reg. § 1.527-2(c)(4).

be subject to tax.⁸⁹ These expenditures include those related to requested appearances before a legislative body and those for nonpartisan activities. Furthermore, the regulations state that two types of expenditures are taxable only to the extent provided in the regulations: indirect expenses and certain expenditures that may be made by unions and trade associations under FECA.⁹⁰ Although the regulations state that these indirect and FECA-allowed expenses are taxable only to the extent provided in the regulations, the Treasury Department has not yet promulgated regulations that state what that extent is. Until the regulations address the matter, it appears these expenses are not for an exempt function.⁹¹

Related Organizations

It is not uncommon to see related tax-exempt organizations. For example, an IRC § 501(c)(3) organization may be paired with an IRC § 501(c)(4) social welfare organization or an IRC § 501(c)(6) trade association. It is not unusual for a trade association, such as the American Bar Association or the American Medical Association, to have a similarly named charitable foundation that conducts charitable activities. It is also common to see a group with a need to lobby as well as conduct charitable activities set up both an IRC § 501(c)(4) organization and an IRC § 501(c)(3) organization. The organizations must be legally separate entities, and their activities and funds must be kept separate.

Additionally, as discussed above, the IRC encourages IRC § 501(c) organizations to set up a separate segregated fund under IRC § 527 in order to avoid the tax on IRC § 527 exempt function expenditures. Incorporated tax-exempt organizations and IRC § 501(c)(5) labor unions also have another reason to establish a separate segregated fund — as mentioned above, federal election laws generally ban these entities from making contributions and expenditures in connection with federal elections. Any IRC § 501(c) organization that is prohibited from participating in political activities by the IRC may not use an IRC § 527 organization to get around the prohibition.⁹² For example, an IRC § 501(c)(3) organization may not establish a separated segregated fund to conduct election-related activities because that would be an indirect way for the IRC § 501(c)(3) organization to participate in political campaign activity.

There are, however, several ways that an IRC § 501(c)(3) organization may be connected to an IRC § 527 organization. For example, individuals involved in the

⁸⁹ See Treas. Reg. § 1.527-6.

⁹⁰ Although FECA generally prohibits unions and corporations from making election-related expenditures, FECA does allow these organizations to make expenditures for internal communications with members, stockholders, and their families that support candidates; conducting nonpartisan registration and get-out-the-vote campaigns aimed at their members, stockholders, and their families; and the establishment, administration, and solicitation of contributions to separate segregated funds. See 2 USC § 441b(b)(2)(C).

⁹¹ See 2002 EO CPE Text, *supra* note 14, at 437.

⁹² See Treas. Reg. § 1.527-6(g).

IRC § 501(c)(3) organization, such as its directors or managers, could establish an IRC § 527 organization separate from the IRC § 501(c)(3) organization. Another possibility is if the IRC § 501(c)(3) organization was established by or related to an organization that has also established an IRC § 527 organization. In any of these situations, it is imperative that the IRC § 501(c)(3) organization be separately organized from the other organizations. This means that all contributions collected by the IRC § 501(c)(3) organization must be kept separate from other funds. Additionally, if the IRC § 501(c)(3) organization and other organizations share offices or staff, the expenses must be allocated between the two organizations and adequate records must be kept. In such a situation, the IRC § 501(c)(3) organization must be careful not to make a contribution to the IRC § 527 organization by, for example, paying expenses that should be allocated to it or providing unreimbursed services or supplies to it.

Reporting and Disclosure Requirements

With the exception of IRC § 527 organizations, the Internal Revenue Code generally does not require tax-exempt organizations to report detailed information about their political activities. Nonetheless, some types of information reported by IRC § 501(c) organizations may give an idea about the extent of the organization's political activities (e.g., the total amount it spends on these activities). These reporting and disclosure requirements are summarized below.

It is important to note that tax-exempt organizations are subject to campaign finance laws and therefore may be required to report information to the FEC. Many IRC § 527 organizations must report to the FEC as political committees. Additionally, organizations that make "electioneering communications" must file a report with the FEC. Electioneering communications are broadcast, cable, or satellite advertisements that refer to a clearly identified federal candidate within sixty days of a general election or thirty days of a primary election and, if a House or Senate election, are targeted to the relevant electorate.⁹³

Initial Application or Notification of Tax-Exempt Status

Application for Tax-Exempt Status. Organizations usually must apply to the IRS for tax-exempt status. Exceptions include IRC § 527 organizations (see below), churches, and small organizations. Organizations that must apply will have to show on the application (Form 1023 or 1024) that they meet the requirements in the appropriate IRC section. The application must include such things as organizing documents (e.g., articles of incorporation or association), financial statements or

⁹³ See 2 USC § 434(f)(3)(A)(i). The FEC had initially carved out an exception for IRC § 501(c)(3) organizations in its regulation interpreting "electioneering communication," presumably on the theory that these communications were already prohibited under the IRC. The regulation was invalidated as being inconsistent with the Bipartisan Campaign Finance Reform Act of 2002 (P.L. 107-155). See *Shays v. Federal Election Commission*, 337 F. Supp. 2d 28 (D.D.C. 2004). When the FEC re-promulgated the regulation, the exception for IRC § 501(c)(3) organizations was not included. 11 CFR § 100.29

budget proposals, and a detailed description of the organization's operations. If an organization plans to lobby or conduct political campaign activity, this information may be included in the organizing documents or explanation of its operations.

If the organization is granted exempt status, the organization and the IRS generally must make the application and supporting documents available to the public.⁹⁴ The organization is subject to a penalty of \$20 per day if it fails to do so.⁹⁵

Notification of 527 Status. IRC § 527 organizations must notify the IRS of their existence by electronically filing Form 8871 within 24 hours of formation.⁹⁶ The requirement does not apply to an organization that anticipates having gross receipts of less than \$25,000 for any year, is a state or local candidate's political committee or a state or local committee of a political party, or is required to report to the FEC as a political committee. The information provided on Form 8871 includes the organization's name, address, and purpose; names and addresses of certain employees and directors; and name of and relationship to any related entities.

The organization and the IRS must make Form 8871 publically available, with the organization being subject to a penalty of \$20 per day for failing to do so.⁹⁷ Additionally, the IRS must post electronically submitted forms in an on-line database within 48 hours of their filing.

Annual Returns

Information Return. Tax-exempt organizations must generally file an annual information return with the IRS using the Form 990 series.⁹⁸ Exceptions exist for such organizations as churches and those with less than \$5,000 in annual gross receipts. Additionally, an IRC § 527 organization is not required to file Form 990 if it has less than \$25,000 in annual gross receipts (\$100,000 if a qualified state or local political organization), is a state or local committee of a political party or a political committee of a state or local candidate, is required to report to the FEC as a political committee, is a caucus or association of state or local officials, is an authorized committee under FECA § 301(6) of a candidate for federal office, is a national committee under FECA § 301(14) of a political party, or is a congressional campaign committee of a political party committee.

Form 990 includes such information as the organization's revenue sources and functional expenses. For purposes of this report, several items are noteworthy. IRC § 501(c)(3) organizations must report their aggregate political expenditures and any excise taxes imposed during the year on their lobbying and political expenditures. They must also report their aggregate lobbying expenditures on Schedule A. Certain

⁹⁴ See IRC § 6104(a) and (d).

⁹⁵ See IRC § 6652(c)(1)(D).

⁹⁶ See IRC § 527(i).

⁹⁷ See IRC §§ 527(k), 6104(a) and (d), and 6652(c)(1)(D).

⁹⁸ See IRC § 6033.

IRC §§ 501(c)(4), (c)(5), and (c)(6) organizations must report the costs of their lobbying and political activities. Additionally, all organizations must report the names and addresses of significant donors, which are generally defined as individuals who contributed at least \$5,000 during the year, on the form's Schedule B.

The organization and the IRS must make publically available the organization's Form 990 for the last three years.⁹⁹ The organization is subject to a penalty of \$20 per day per return (limited to \$10,000) for failing to do so.¹⁰⁰ However, whether the information on Schedule B is publically available will depend on the type of organization.¹⁰¹ Only private foundations and IRC § 527 organizations must disclose all of Schedule B. For other organizations, any identifying information of the contributors will not be publically disclosed.

Excise Tax Returns. Organizations that owe the penalty and excise taxes mentioned in this report must file an excise tax return (e.g., Form 4720 or Form 1120-POL). The return includes such information as the aggregate totals of the taxable expenditures and taxes owed and the names of managers who approved the activities.

Neither the organization nor the IRS is required to make any tax return available to the public.

Disclosure of Expenditures and Contributions

IRC § 527 organizations that accept a contribution or make an expenditure for an exempt function must periodically file a disclosure report, Form 8872, with the IRS.¹⁰² There is no comparable requirement for the other tax-exempt organizations.

The IRC § 527 organization may file on a (1) quarterly basis in a year with a regularly scheduled election and semi-annually in any other year or (2) monthly basis. There are additional requirements for pre-general election, post-general election, and year-end reports. A periodic report must include (1) the name, address, occupation, and employer of any contributor who makes a contribution during the reporting period and has given at least \$200 during the year, along with the amount and date of the contribution, and (2) the amount, date, and purpose of each expenditure made to a person during the reporting period if that person has received at least \$500 during the year, along with the person's name, address, occupation, and employer. The failure to file a timely or accurate Form 8872 is subject to a penalty equal to the highest corporate tax rate multiplied by the amount of contributions and/or expenditures to which the failure relates.

The disclosure requirements do not apply to an IRC § 527 organization that anticipates having gross receipts of less than \$25,000 for any year, is a political

⁹⁹ See IRC § 6104(b) and (d).

¹⁰⁰ See IRC § 6652(c)(1)(C).

¹⁰¹ See IRC § 6104(b) and (d).

¹⁰² See IRC § 527(j).

committee of a state or local candidate, is a state or local committee of a political party, is required to report to the FEC as a political committee, or is a qualified state or local political organization. The requirements also do not apply to any expenditure that is an independent expenditure (i.e., an expenditure that expressly advocates for a candidate but is made without the candidate's cooperation).

The IRS and the IRC § 527 organization must make the forms available to the public.¹⁰³ The organization is subject to a penalty of \$20 per day, which is limited to \$10,000 per return.¹⁰⁴ Additionally, the IRS must post electronically submitted forms in an online database within 48 hours of their filing.

¹⁰³ See IRC §§ 527(k) and 6104(d).

¹⁰⁴ See IRC § 6652(c)(1)(C).