

501 (c)(3) Restrictions on Conducting Political Activity
IRS Revenue Ruling 2004-4
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Non profit organizations should expect to see IRS rulings and regulations to ensure more strict compliance with tax exemption benefits. Revenue Ruling 2004-6, 2004-4 IRB 328, defines political activity in issue ads and could impact numerous non-profit organizations.

Rev. Rul. 2004-6 specifically applies to sections 501(c)(4), 501(c)(5), and 501(c)(6) organizations that wish to determine whether an issue ad is in fact a political activity, therefore constituting an exempt function that is subject to tax under section 527(f). However, section 501(c)(3) groups may be implicitly included in the Ruling because these groups are prohibited from participating in political activities, and the Ruling provides a list of specific factors that tend to show if an issue ad is political or not.

Discussion

History and Reasoning Behind the Ruling

During the 1996 election year, various groups took advantage of a legal loophole in the campaign finance system, which allowed certain nonprofit organizations to run issue advocacy advertising that were unregulated by federal election laws.¹ Issue advocacy (issue ads) are defined as communications whose purpose is to promote a policy position but does not expressly call for the election or defeat of a candidate for office.² In an effort to use tax-exempt funds for clearly partisan agendas, numerous section 527 organizations were formed, with the primary purpose of funding issue ads that all but fell short of endorsing or opposing a candidate. These groups used their nonprofit status to shield the identity of their donors, from whom they accepted unlimited contributions.³ With that history in mind, on the eve of an election year, the IRS released Rev. Rul. 2004-6, to further clarify the Federal Election Campaign Act, as amended by the Bipartisan Campaign Reform Act of 2002, as to what constitutes as political activity in an issue ad, thereby qualifying as taxable to certain 501(c) organizations.

Political activity further defined

Charitable, religious or educational organizations which are exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code, and have the privilege of receiving contributions from private parties that are tax deductible for the contributor, are absolutely forbidden by the Code to “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.”⁴ Revenue Ruling 2004-6 is significant because it addresses the issue of what

¹ <http://www.annenbergpublicpolicycenter.org/issueads/glossary.htm>.

² *Buckley v. Valeo*, 424 U.S. 1, 96 S. Ct. 612, 46 L.Ed. 2d 659 (1976).

³ <http://www.pbs.org/wgbh/pages/frontline/shows/scandal/etc/ads.html>.

⁴ I.R.C § 501(c)(3).

constitutes an attempt to influence the election of an individual to public office; which is absolutely prohibited activity for 501(c)(3) organizations and is permitted for other 501(c) organizations who are then taxed on this “exempt function” but risk losing it if such attempts become their primary activity.⁵ The Ruling set forth specific factors, which can be used to determine if a communication is a partisan or nonpartisan activity.

According to the Ruling, these six factors tend to show that an advocacy communication on a public issue is **political activity**:

- The communication identifies a candidate for public office;
- The timing of the communication coincides with an electoral campaign;
- The communication targets voters in a particular election;
- The communication identifies that candidate’s position on the public policy issue that is the subject of the communication;
- The candidate’s position on the public policy issue has been raised as distinguishing the candidate from others in the campaign, either in the communication itself or in other public communications; and
- The communication is not part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.

Five factors that tend to show that a communication is **not political** include:

- The absence of any one or more of the factors listed above;
- The communication identifies specific legislation, or a specific event outside the control of the organization, that the organization hopes to influence;
- The timing of the communication coincides with a specific event outside the control of the organization that the organization hopes to influence, such as a legislative vote or other major legislative action (for example, a hearing before a legislative committee on the issue that is the subject of the communication);
- The communication identifies the candidate solely as a government official who is in a position to act on the public policy issue in connection with the specific event (such as a legislator who is eligible to vote on the legislation); and
- The communication identifies the candidate solely in the list of key or principal sponsors of the legislation that is the subject of the communication.

501(c)(3) organizations should also be aware that according to *I.R.S Publication 1828*, certain activities or expenditures might not be prohibited depending on the facts and circumstances. For example, certain voter education activities (including the presentation of public forums and the publication of voter education guides) conducted in a non-partisan manner do not constitute prohibited political campaign activity.⁶

In addition, other activities intended to encourage people to participate in the electoral process, such as voter registration and get-out-the-vote drives, would not constitute prohibited

⁵ Lloyd H. Mayer, Political Activities of Tax-Exempt Organizations-Useful Guidance in Rev. Rul. 2004-6, 100 J. Tax’n 181 (2004).

⁶ I.R.S Publication 1828

political campaign activity if conducted in a non-partisan manner.⁷ On the other hand, voter education or registration activities with evidence of bias that: (a) would favor one candidate over another; (b) oppose a candidate in some manner; or (c) have the effect of favoring a candidate or group of candidates, will constitute prohibited participation or intervention.⁸

Section 501(c)(3) Organizations and Insubstantial Lobbying Requirement

The Code does allow for section 501(c)(3) organizations to lobby as long as the activities do not constitute a “substantial part” of the organization’s activities. Section 501(c)(3) organizations may be eligible to make an election to engage in direct and grassroots lobbying under section 501(h), but will be governed by limits expressed as a percentage of “exempt purpose expenditures.”

However, not all IRC 501(c)(3) organizations are permitted to make that election. The only organizations that may elect to lobby under IRC 501(h) include:

- Section 170(b)(1)(A)(ii) (relating to educational institutions),
- Section 170(b)(1)(A)(iv) (relating to organizations supporting (supported by) government schools),
- Section 170(b)(1)(A)(vi) (relating to organizations publicly supported by charitable contributions),
- Section 509(a)(3) (relating to organizations supporting certain types of public charities) [except that for purposes of this subparagraph, section 509(a)(3) shall be applied without regard to the last sentence of section 509(a)].

and which **are not**:

- (A) Described in section 170(b)(1)(A)(i) (**relating to churches**),
- (B) An integrated **auxiliary of a church** or of a convention or **association of churches**.

For section 501(c)(3) organizations which are eligible for and choose to make the section 501(h) election, the annual, permissible lobbying amount is determined as a percentage of "exempt-purpose expenditures," i.e., amounts spent to accomplish the mission of the organization, *not including fundraising costs*.⁹

Section 4911(c)(2) provides the following limits: (1) If exempt-purpose expenditures do not exceed \$500,000, the lobbying amount is 20% of expenditures; (2) if exempt-purpose expenditures exceed \$500,000, but do not exceed \$1 million, the lobbying amount is \$100,000 plus 15% of expenditures in excess of \$500,000; (3) if exempt-purpose expenditures exceed \$1 million but do not exceed \$1.5 million, the lobbying amount is \$175,000 plus 10% of the expenditures over \$1 million; and (4) if exempt-purpose expenditures exceed \$1.5 million, the lobbying amount is \$225,000 plus 5% of the excess of the expenditures over \$1.5 million. The "grassroots" lobbying limit is 25% of the organization's permissible lobbying amount for that year. It is, thus, a "sub-limit."

⁷ id

⁸ id

⁹ I.R.C. § 4911(e)(1)(A).

ECI appears to qualify as a 501 (c)(3) organization eligible to qualify for a 501 (h) election because it is a section 170(b)(1)(A)(iv), organization supported by a government school, and is not a church or related to a church.

What is Lobbying?

Lobbying is the act of attempting to influence legislation, either directly or indirectly, however, these activities and communications are **not considered lobbying**.¹⁰

- Making available the results of nonpartisan analysis, study, or research;
- Providing of technical advice or assistance (where such advice would otherwise constitute the influencing of legislation) to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be;
- Appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization;
- Communications between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to the organization and such members, unless the communications directly encourage the members to attempt to influence legislation or directly encourage the members to urge nonmembers to attempt to influence legislation;
- Any communication with a government official or employee, other than—(a) a communication with a member or employee of a legislative body (where such communication would otherwise constitute the influencing of legislation), or (b) a communication the principal purpose of which is to influence legislation;
- Conducting educational meetings, preparing and distributing educational materials, or otherwise consider public policy issues in an educational manner.

It must be noted that certain transfers will be treated as lobbying.¹¹ A transfer of money or property by a 501(c)(3) organization to an individual or entity will be treated as a lobbying expenditure if it is earmarked for that purpose. A transfer of money or property by a 501(c)(3) organization for less than fair market value to a non-501(c)(3) organization that lobbies will be treated as a lobbying expenditure unless it is a "controlled grant" or unless certain other exceptions apply.

Conclusion

The Ruling evidences the IRS's new bright line position against tax-exempt funds being used for political purposes, especially during an election period. All 501(c) organizations should be conscious of any new Rulings issued on this matter. To preserve the tax-exempt status, 501(c)(3) organizations should refrain from any engagement in political activities besides those

¹⁰ I.R.C § 4911(d)(2) and Treas. Reg. § 56.4911-2(c).

¹¹ Treas. Reg. § 56.4911-3(b)(3).

exceptions previously stated. The strict rules for restrictions concerning insubstantial lobbying must also be adhered to.

A Note about IRS Electronic Filing Rules

Question presented

Under newly released IRS regulations some tax exempt organizations will be required to file its tax forms electronically beginning in 2006 or 2007.

Beginning in 2006 any tax exempt organization that has assets of \$100 million or more shall be required to e-file its tax returns. The regulations also only applies to entities that file at least 250 returns during a calendar year. Returns included to make the 250 total include each W-2 form filled for employees, along with excise or income tax forms. The same should result in 2007 where e-filing will be required for tax-exempt organizations with assets totaling \$10 million or more. Finally, only private foundations and charitable trusts will be required to file Form 990-F electronically regardless of their asset size.