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TO: Clients

FROM: Trister, Ross, Schadler & Gold, PLLC

RE: IRS Notice of Proposed Rulemaking on Political Activities of 501(c)(4) Social Welfare Organizations and Potentially Other Groups

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OVERVIEW

Last week, the Internal Revenue Service released a Notice of Proposed Rulemaking (NPRM) to substantially revise the treatment of political activities by Internal Revenue Code (IRC) section 501(c)(4) "social welfare organizations." 78 Fed. Reg. 71535 (Nov. 29, 2013). Contrary to some reports, *no new rules are in effect yet*, and there is no set timetable for final regulations.

Although this rulemaking is directed to 501(c)(4)s, the NPRM asks whether similar rules should apply to charities (501(c)(3)s), labor organizations (501(c)(5)s) and trade associations (501(c)(6)s). And, the NPRM asks how a redefinition of "political" activity for these groups should affect the treatment of political activity for section 527 "political organizations" themselves (in IRS terminology, "exempt function" activity). Because many 501(c) groups (except (501(c)(3)s) sponsor and rely for much of their political spending on separate segregated funds that are regulated by section 527, any IRS changes on this subject could have broad impact.

The proposed 501(c)(4) regulations seek to more clearly define the activities and expenditures that will be treated as "political," as distinct from "social welfare," for 501(c)(4) groups – and the new rules would substantially expand the former at the expense of the latter. Relatedly, the IRS asks for comments on whether and how its longstanding and unquantified "primary purpose" standard for 501(c)(4) "social welfare" activity should be revised to specify how much, if any, political activity (as redefined) a social welfare organization may conduct.

The NPRM requests comments from the public by February 27, 2014, regarding the proposed regulations and the other issues raised by the IRS in its accompanying explanation. Although the NPRM suggests no timetable for adopting final rules, nothing is likely to be issued or effective until sometime after the November 4, 2014 general election.

The following Q&A explains the IRS proposal and the potential consequences if it were adopted as proposed.

Q. What prompted this rulemaking?

A. The IRS doesn't say; it refers generally to "recent[] increased attention [to] potential political campaign intervention" by 501(c)(4) groups. It seems likely that the controversy over the IRS's handling of applications for 501(c)(4) tax qualification by "tea party" groups, which prompted media scrutiny of the subjective nature of IRS judgments about what is "political activity," triggered this formal effort to revise the rules for the first time in 54 years.

Q. What are the current IRS rules that apply to 501(c)(4) political activity?

A. Current IRS regulations that date from 1959 provide that a 501(c)(4) organization is operated "exclusively for the promotion of social welfare" (as the IRC says) if it is "primarily" engaged in activities that promote the common good and general welfare of the people of the community. The regulations (though not the IRC) provide that participation in political campaigns does *not* qualify as an activity that promotes social welfare. Therefore, if an organization's primary purpose or activity *is* partisan political activity, the organization does *not* qualify as a 501(c)(4) group. Generally, partisan political activities of 501(c)(4) (and other 501(c)) groups are those that support or oppose a candidate for elected public office or a political party, and the IRS has used a flexible *"facts and circumstances"* approach rather than specific guidelines to determine what they are.

In addition to the primary-purpose restriction, 501(c)(4) organizations that have net investment income (interest, dividends, capital gains, rents and royalties) may be subject to a 35% federal tax on the lesser of their investment income or the expenditures for their political activities under IRC section 527(f)(1) & (2), unless they conduct these activities through a "separate segregated fund" that is organized under IRC section 527(f)(3). So, a 501(c)(4) group's programmatic choices can entail substantial and costly consequences depending on the IRS's classification of activities as "political."

Q. What is the main difference between the current "facts and circumstances" test and the proposed standard for defining political activity?

A. The NPRM introduces a new term – "direct or indirect candidate-related political activity" – to define the activities and expenditures that would be treated as political, meaning that, specifically, they would *not* be "social welfare" activities, and, in the aggregate, they could *not* comprise the "primary purpose" of a 501(c)(4) organization.

This new category is much broader than what the "facts and circumstances" test covers. That test tries to identify *partisan* political activity – conduct that is designed to achieve particular election outcomes or to favor particular political parties. In contrast, the proposed standard includes inherently partisan spending on such activities as express advocacy and political contributions, but it also covers *any* near-election references of any kind to any candidate (including incumbents) in any media, even if purely legislative, as well as nonpartisan voter registration, GOTV efforts and voter guides, and advocacy about *appointed* executive branch and judicial officeholders. The NPRM's stated overriding goal is "greater certainty" and "reduc[ing] the need for detailed factual analysis" in defining what is "political."

Q. What activities that plainly *are* partisan would be included in the revised "political" category?

A. The following activities that are self-evidently partisan in nature would be included:

1. Express advocacy and its functional equivalent. Communications regarding the nomination or election of either a clearly identified candidate for elective office or the candidates of a particular political party that *either*:

- Contain so-called magic words that expressly advocate for or against that result, such as "vote," "oppose," "support," "elect," "defeat," or "reject", *or*
- Are susceptible to no reasonable interpretation other than as a call for or against that result (what is often called "the "functional equivalent" of express advocacy)

This covers *all* forms of communication, including "oral" messages, regardless of how many recipients are intended or reached. And, this includes, but is not limited to, "independent expenditures" that are reported to the Federal Election Commission (FEC).

2. Contributions and solicitations of contributions. Either a contribution of money or anything of value to, or the *solicitation* of contributions on behalf of, *either*:

- Any person, if the contribution is recognized by federal, state, or local campaign finance law as a reportable contribution to a candidate for elective office; *or*

- Any section 527 organization (so, this includes a 501(c)(4) group's own PAC)

3. **Republication of candidate or 527 group materials.** Distribution of any written, electronic or other material that is prepared by or on behalf of a candidate or a section 527 organization.

4. **FEC-reported membership communications.** Express-advocacy communications about federal candidates by a 501(c)(4) that are reportable to the FEC on Form 7.

5. **Recall elections.** Express advocacy or its functional equivalent with respect to whether or not an incumbent officeholder should be subjected to a recall, a procedure that exists in numerous states and localities but not at the federal level. The IRS has not previously definitively addressed whether or not contributions or expenditures in recall elections qualify as political activity in the same manner as regular elections.

Q. What activities that are *not* necessarily partisan would be included in the revised "political" category?

A. The new "political" standard would cover many activities that either are not partisan or are not necessarily partisan, and it would not matter that, in fact, the activity as undertaken *is* indisputably nonpartisan and permissible for even a 501(c)(3) organization to undertake. These activities include:

1. Contributions to another section 501(c) organization that *itself* engages in *any* "candidate-related political activity." The current standard for "political" activity by 501(c)(4)s only reaches contributions if they are earmarked for political purposes or if the 501(c)(4) does not take reasonable steps to ensure that the recipient does not use the funds for 527 exempt function activities. The new standard effectively would reverse that by covering *all* contributions to another 501(c) group of any kind (including 501(c)(3), (4), (5) or (6)) that engages in *any* "political activity" (as redefined), regardless of whether the contribution is either restricted or used for *non*-political activity. The proposal does not explain what time period applies to evaluate the recipient's status as a group that does not engage in "political" activity.

And, in order for a such a contribution to avoid treatment as "political" spending, the contributor 501(c)(4) must obtain a written representation from the recipient stating that the recipient *does not* engage in candidate-related political activity (and, the contributor must neither know nor have reason to know that this representation is inaccurate or unreliable), *and* there must be a written restriction prohibiting use the contribution for political activity.

This would create a tremendous deterrent against contributions by 501(c)(4) groups to other tax-exempt groups, as well as a tremendous deterrent against engaging in "political" activity as redefined.

2. Advocating the appointment or confirmation of government executives and judges. This provision covers both express advocacy and its functional equivalent regarding whether or not a clearly-identified individual should be appointed, nominated or confirmed to a federal, state or local executive branch or judicial position. The proposal incorrectly asserts that under current law this activity is treated as "political" activity. Rather, following review of the issue in the aftermath of the 1988 Robert Bork Supreme Court nomination, the IRS has stated that activities to influence a legislature's consideration of an appointment comprise lobbying and do not constitute participation or intervention in a political campaign within the meaning of IRC section 501(c)(3).

3. "Electioneering communications." Any "public communication" within 30 days of a primary election or 60 days of a general election that refers (*without* express advocacy or its functional equivalent) in any manner to one or more clearly-identified federal, state or local candidates (including an incumbent officeholder) in that election, or, in the case of a general election, refers to one or more political parties in that election is treated as candidate-related. "Public communications" include messages via broadcast, cable, satellite, website, newspaper, magazine, other periodical, any form of paid advertising, or that otherwise are intended to or do reach more than 500 persons. So, this category is far broader than what the FEC defines as "electioneering communications," which are confined to references to *federal* candidates in *broadcast* media. The coverage of "electioneering communications" is also broader than many state law provisions that regulate these types of communications; and, in fact, most states do *not* regulate them.

4. Voter registration and "get-out-the-vote" drives. These activities are covered regardless of whether the activity is nonpartisan and can, at least currently, be conducted by a 501(c)(3) organization.

5. Voter guides. These are included if they either refer to or attach anything that refers to any clearly identified candidate or, in a general election, any political party, also regardless of whether they are nonpartisan. It is unclear what would be considered a voter guide, and the rule could include voting records frequently circulated even by 501(c)(3) public charities.

6. Candidate appearances. Candidate appearances may take many forms, only some of which are partisan. Nonpartisan candidate debates and other events, even within 30 days of a primary election or 60 days of a general election, in which one or more candidates participate, may

currently be sponsored by public charities and 501(c)(4)s and not be treated as partisan political activity. And, under current IRS standards, there are many circumstances in which incumbent officeholders who are also candidates in an upcoming election meet, speak and appear in their official capacities, and the event is treated as nonpartisan.

Q. Does the IRS suggest how 501(c)(4) "primary purpose" should be calculated?

A. No. The NPRM asks whether and how to quantify how much of an organization's activity must promote social welfare for the organization to qualify under section 501(c)(4). The NPRM suggests that the IRS might conclude that – like 501(c)(3)s – 501(c)(4)s can't engage in *any* political activity. The IRS also asks for comment about how it should "measure" political activity for *applicants* for 501(c)(4) status. And, although the IRS proposes no specific rule to define "primary purpose," it is possible that the final rules may do so without the IRS first proposing anything specific on the subject.

Q. Would the amount of a group's political activity be determined only by its spending?

A. No. Activities conducted by a 501(c)(4) organization that would be considered in evaluating its "political" activity include those that are either paid for by the organization, conducted by an officer, director, or employee acting in that capacity, or conducted by a *volunteer* acting under the organization's direction or supervision. So, the IRS does not propose simply an "expenditure" test for calculating "primary purpose"; *non*-spending would be counted, but the NPRM doesn't suggest how it would be quantified or affect the determination of primary purpose.

Q. Would these rules require additional disclosures by 501(c)(4) groups?

A. Indirectly, most likely yes. The new standard for political activity would cause many groups to forgo certain activity completely or substantially in order to maintain their "social welfare" purpose, in order to avoid the 35% 527(f) tax, or both. Many groups likely would shift "political" activity as redefined to a self-financed, sponsored 527 "separate segregated fund" (SSF) that, under current law, must itemize most of its spending and receipts in periodic public reports.

An issue that is raised by the NPRM, but not addressed, is whether the option of shifting political activities from a 501(c)(4) to a 527 as suggested above will be impossible in some circumstances. IRS rules currently bar SSFs from spending more than an "insubstantial" amount on anything except "exempt function" activity under section 527. So, if what is "political" for a 501(c)(4) is broader and does not align with what is 527 "exempt function" activity, a 501(c)(4) group could find itself facing unpalatable choices outside of its power to resolve. For example, the 501(c)(4) would be precluded from undertaking an activity because it would jeopardize its exempt status by conducting excessive political activity, and the

527 SSF would also be precluded from engaging in the activity because it does not constitute an "exempt function" activity.

Q. How would these rules affect a 501(c)(4) group's website?

A. Websites would be fully covered. For example, the IRS explains that "content previously posted by an organization on its website that clearly identifies a candidate and remains on the website during the specified pre-election period would be treated as candidate-related political activity." So, an organization may have to choose between counting some or all of the website costs as "political" or scrubbing its website during those periods of all references to "candidates," regardless of the fact that they only pertain to incumbents' official conduct and regardless of their importance and immediacy to the group's legislative and advocacy programs and needs. The NPRM also asks for comments on: whether and under what circumstances material posted by a *third party* on an organization's website should be attributed to the organization, and whether establishing and maintaining a link to another website that contains candidate-related political activity, where the linking organization has no control over the content, should be attributed to the 501(c)(4) as its own activity.

Q. Would the 501(c)(4) definition of political activity be the same for 501(c)(3) organizations, which are prohibited from engaging in *any* direct or indirect participation or intervention in political campaigns?

A. Not necessarily. While the IRS requests comments on whether there should also be new rules for 501(c)(3) organizations' political activities, the NPRM asks whether 501(c)(4) "political" activities should overlap but differ from those for 501(c)(3) groups. The IRS says a "more nuanced" approach may be necessary for 501(c)(3)s because they are prohibited from undertaking *any* political activities.

Q. Would the same definition be used for labor organizations and trade associations to determine their activities that are political and do not constitute their primary purpose?

A. Possibly. Although the IRC and the IRS regulations do *not* specify that labor organizations or trade associations must have a particular "exclusive" or "primary" purpose, the IRS does apply a primary-purpose standard to them. And, like 501(c)(4)s, they are subject to the 527(f) tax on their political activities. The NPRM explicitly asks for comments about whether they should be subject to the same "political" activity standards as 501(c)(4)s. The NPRM asserts that any such revised rules for those groups would be adopted only after another rulemaking (which could be initiated at any time). So, how the IRS redefines political activities for 501(c)(4)s effectively could determine how they are redefined for unions and trade associations as well.