

NEW PROPOSED REGULATION CONCERNING TAX-EXEMPT SOCIAL WELFARE ORGANIZATIONS THAT ENGAGE IN POLITICAL ACTIVITIES

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In the midst of continuing and highly politicized Congressional inquiries into Internal Revenue Service scrutiny of political activities of Code §501(c)(4) tax-exempt social welfare organization, the Treasury Department has released a proposed regulation defining what constitutes “candidate-related political activity” and taking the position that the promotion of social welfare does not include this type of activity. (See Federal Register, p.71535-71542, November 29, 2013.)

The proposed regulation comes six months after a scandal erupted over alleged unfair targeting by the IRS of exemption applications filed by conservative organizations thought to be involved in supporting candidates in the 2012 elections. The alleged targeting took place against a backdrop of exponentially increased spending on campaign issues beginning with the 2008 elections by organizations claiming tax exempt status under Code §501(c)(4). (See Wall Street Journal, *IRS Moves to Restrict Nonprofits' Politicking*, November 27, 2013.)

The comment period concerning the newly issued proposed regulation runs until February 27, 2014. Comments are also being sought concerning how much of a Code §501(c)(4) organization's activities must promote social welfare and whether the candidate-related political activity definition ought to be used in other contexts (such as to define political activities that do not further the tax-exempt purposes of other types of tax exempt organizations). In this regard, the Treasury Department is hoping to craft regulations that will have more clear cut, objective rules that will reduce the need for fact-intensive inquiries into an organization's activities.

Outlined below are the current standards for political activity by Code §501(c)(4) organizations, a summary of the new proposed regulation and a brief discussion of the comments sought on related topics.

I. Code §501(c)(4) and current standards concerning political activity by social welfare organizations.

Code §501(c)(4) organizations are defined in the Code 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, education, or recreational purposes.” No part of the net earnings of a Code §501(c)(4) organization may inure to the benefit of any private shareholder or individual.

Significantly, the Code states that social welfare organizations must be *operated exclusively* for the promotion of social welfare, and the current Treasury regulations reiterate that standard in Treas. Reg. 1.501(c)(4)-1(a)(1). However, the regulations then go on to explain that:

“An 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. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.” Treas. Reg. 1.501(c)(4)-1(a)(2)(i).

Thus, the regulations relax the *operated exclusively* requirement in the Code to an *operated primarily* (or *primarily engaged*) standard. The *operated primarily* standard has been further interpreted by some Code §501(c)(4) organizations as meaning 51% of their operations and funds must be dedicated to activities that constitute social welfare activities.

The current Treasury regulations state that: “The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.” Treas. Reg. §1.501(c)(4)-1(a)(2)(ii). But the regulations further note that an organization may qualify for tax exemption as a social welfare organization even if it is an “action” organization as defined in Treas. Reg. §1.501(c)(3)-1(c)(3)(ii) or (iv), if the organization otherwise meets the criteria of Code §501(c)(4). The two cited sections of the Code §501(c)(3) regulations describe certain types of organizations that attempt to influence legislation and engage in advocacy pertaining to legislation – actions that Code 501(c)(3) tax-exempt charities may not engage in except on an “insubstantial” basis.

Treas. Reg. §1.501(c)(3)-1(c)(3)(ii) states:

“An organization is an “action” organization if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise. For this purpose, an organization will be regarded as attempting to influence legislation if the organization (a) Contacts or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or (b) Advocates the adoption or rejection of legislation.”

Treas. Reg. §1.501(c)(3)-1(c)(3)(iv) states:

“An organization is an “action” organization if it has the following two characteristics: (a) Its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and (b) It advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public.

The combination of the loosening of the *operated exclusively* requirement and the explicit approval of certain forms of political activity has made Code §501(c)(4) organizations a particularly attractive vehicle for propagating political speech in recent elections. This is so especially because Code §501(c)(4) organizations, unlike Code §527 political organizations, are not required to disclose the identity of their contributors. Meanwhile, the government’s ability to regulate Code §501(c)(4) organizations has been hampered by a sizable increase in the number of organizations seeking exempt status under Code §501(c)(4) and the lack of specific criteria to

qualify for exemption under that section. IRS reviewers are left to assess the “facts and circumstances” of each organization with little guidance from the existing Code §501(c)(4) regulations and other published guidance.

II. New Proposed Regulation Concerning Candidate-Related Political Activities.

The recently issued proposed regulation aims to provide some guidance to social welfare organizations and to IRS reviewers about certain types of political activities that will not be deemed to promote social welfare within the meaning of Code §501(c)(4). While the proposed regulation does not change the current provisions that acknowledge that a social welfare organization may engage in certain activities to influence legislation or advocate concerning legislation, the proposed regulation refines the current prohibition on direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office by expanding it to prohibit direct or indirect “candidate-related political activity.” Prop. Treas. Reg. 1.501(c)(4)-1(a)(2)(ii).

“Candidate-related political activity” is defined in the proposed regulation as including:

- Any **communications** that expressly advocate, whether for or against, the selection, nomination, election or appointment of a clearly identified candidate of a political party; or that clearly identify a candidate or political party and are made within 60 days of a general election or 30 days of a primary; or that must be reported to the Federal Election Commission;
- Any **contribution** (including gifts, grants and loans) to, or the solicitation of contributions on behalf of, any person if the transfer is reportable under federal, state or local campaign finance law; or to any Code §527 political organization or to a Code §501(c) organization that engages in candidate-related political activity;
- **Voter registration drives** and “**get out the vote**” drives;
- Any **distribution of material** prepared by or on behalf of a candidate or by a Code §527 political organization; or preparation or distribution of a voter guide that refers to one or more clearly identified candidates or, in the case of a general election to one or more political parties; and
- **Hosting or conducting an event** within 30 days of a primary election or 60 days of general election at which one or more candidates in such election appear as part of the program.

Prop. Treas. Reg. 1.501(c)(4)-1(a)(2)(iii). (The complete text of the definition is provided at the end of this article.)

It seems clear that one goal of the new concept of “candidate-related political activity” is to reach activities that indirectly benefit (or disadvantage) individual candidates, but which do not rise to the level of “direct or indirect participation or intervention” in political campaigns. In addition, the greater specificity of prohibited activities will make it somewhat easier to objectively determine whether an organization is violating the rules. However, the proposed

regulations are silent about what is perhaps the more glaring problem with the current regulations: the disconnect between the statutory requirement that a social welfare organization be *operated exclusively* for the promotion of social welfare and the currently regulations that say that a social welfare organization need only be *operated primarily* for such purposes. Thus, it is not clear to what extent the proposed regulations, even if adopted a final regulations, will change the status quo.

III. Comments Sought on Related Topics

In addition to seeking comments about the new concept of candidate-related political activity, the Treasury Department is seeking comments about the proportion of a Code §501(c)(4) organization's activities that must promote social welfare. If one believes that social welfare organizations are being improperly used to advance blatantly political agendas, merely having an expanded prohibition on involvement in campaigns will not remedy the problem if social welfare organizations can still devote 49% of their resources to otherwise prohibited political activities. Thus, it will be interesting to see what comments the Treasury Department receives about this issue. Notably, the Treasury Department is currently being sued for declaratory, injunctive and mandamus relief in Federal District Court for the District of Columbia to compel the IRS to stop using the current *operated primarily* standard and to issue new regulations that would harmonize with the *operated exclusively* statutory language. (See *Citizens for Responsibility and Ethics in Washington v. U.S. Department of Treasury*, Civil Action No. 13-732 (JDB).)

The Treasury is also seeking comments on the interaction of the standards concerning campaign intervention under Code §501(c)(3) with those of Code §501(c)(4), and whether there should be restrictions on campaign activities by §501(c)(5) organizations (labor, agricultural and horticultural organizations) and §501(c)(6) organizations (business leagues, chambers of commerce, etc.) like those being proposed for Code §501(c)(4) organizations. In keeping with its goal of moving away from a "facts and circumstances" approach in areas concerning political activity, the Treasury Department has also invited comments as to whether the definition of an "exempt function" activity that applies to political organizations under Code §527 should be revised along the lines of the proposed definition of candidate-related political activity for Code §501(c)(4) organizations.

IV. Conclusion

Code §501(c)(4) organizations accounted for only a small percentage of the total campaign spending on elections in 2012. However, there is compelling evidence that specific Code §501(c)(4) organizations had a substantial impact on a handful of hotly contested races. This raises important questions for America to grapple with. The issues of money and campaign spending are much larger than the more limited questions facing the IRS concerning the standards for tax-exemption under Code §501(c)(4) organizations, or even whether donors should be able to anonymously fund campaign activities through tax-exempt Code §501(c)(4) social welfare organizations. The puzzle that is campaign financing in America has many pieces.

Proposed Treasury Regulation §1.501(c)(4)-1(a)(iii)

Definition of candidate-related political activity.

(A) *In general.* For purposes of this section, candidate-related political activity means:

(1) Any communication (as defined in paragraph (a)(2)(iii)(B)(3) of this section) expressing a view on, whether for or against, the selection, nomination, election, or appointment of one or more clearly identified candidates or of candidates of a political party that—

(i) Contains words that expressly advocate, such as “vote,” “oppose,” “support,” “elect,” “defeat,” or “reject,” or

(ii) Is susceptible of no reasonable interpretation other than a call for or against the selection, nomination, election, or appointment of one or more candidates or of candidates of a political party;

(2) Any public communication (defined in paragraph (a)(2)(iii)(B)(5) of this section) within 30 days of a primary election or 60 days of a general election that refers to one or more clearly identified candidates in that election or, in the case of a general election, refers to one or more political parties represented in that election;

(3) Any communication the expenditures for which are reported to the Federal Election Commission, including independent expenditures and electioneering communications;

(4) A contribution (including a gift, grant, subscription, loan, advance, or deposit) of money or anything of value to or the solicitation of contributions on behalf of—

(i) Any person, if the transfer is recognized under applicable federal, state, or local campaign finance law as a reportable contribution to a candidate for elective office;

(ii) Any section 527 organization; or

(iii) Any organization described in section 501(c) that engages in candidate-related political activity within the meaning of this paragraph (a)(2)(iii) (see special rule in paragraph (a)(2)(iii)(D) of this section);

(5) Conduct of a voter registration drive or “get-out-the-vote” drive;

(6) Distribution of any material prepared by or on behalf of a candidate or by a section 527 organization including, without limitation, written materials, and audio and video recordings;

(7) Preparation or distribution of a voter guide that refers to one or more clearly identified candidates or, in the case of a general election, to one or more political parties (including material accompanying the voter guide); or

(8) Hosting or conducting an event within 30 days of a primary election or 60 days of a general election at which one or more candidates in such election appear as part of the program.

(B) *Related definitions.* The following terms are defined for purposes of this paragraph (a)(2)(iii) only:

(1) “*Candidate*” means an individual who publicly offers himself, or is proposed by another, for selection, nomination, election, or appointment to any federal, state, or local public office or office in a political organization, or to be a Presidential or Vice-Presidential elector, whether or not such individual is ultimately selected, nominated, elected, or appointed. Any officeholder who is the subject of a recall election shall be treated as a candidate in the recall election.

(2) “*Clearly identified*” means the name of the candidate involved appears, a photograph or drawing of the candidate appears, or the identity of the candidate is apparent by reference, such as by use of the candidate's recorded voice or of terms such as “the Mayor,” “your Congressman,” “the incumbent,” “the Democratic nominee,” or “the Republican candidate for County Supervisor.” In addition, a candidate may be “clearly identified” by reference to an issue or characteristic used to distinguish the candidate from other candidates.

(3) “*Communication*” means any communication by whatever means, including written, printed, electronic (including Internet), video, or oral communications.

(4) “*Election*” means a general, special, primary, or runoff election for federal, state, or local office; a convention or caucus of a political party that has authority to nominate a candidate for federal, state or local office; a primary election held for the selection of delegates to a national nominating convention of a political party; or a primary election held for the expression of a preference for the nomination of individuals for election to the office of President. A special election or a runoff election is treated as a primary election if held to nominate a candidate. A convention or caucus of a political party that has authority to nominate a candidate is also treated as a primary election. A special election or a runoff election is treated as a general election if held to elect a candidate. Any election or ballot measure to recall an individual who holds state or local elective public office is also treated as a general election.

(5) “*Public communication*” means any communication (as defined in paragraph (a)(2)(iii)(B)(3) of this section)—

(i) By broadcast, cable, or satellite;

(ii) On an Internet Web site;

(iii) In a newspaper, magazine, or other periodical;

(iv) In the form of paid advertising; or

(v) That otherwise reaches, or is intended to reach, more than 500 persons.

(6) “*Section 527 organization*” means an organization described in section 527(e)(1) (including a separate segregated fund described in section 527(f)(3)), whether or not the organization has filed notice under section 527(i).

(C) *Attribution*. For purposes of this section, activities conducted by an organization include activities paid for by the organization or conducted by an officer, director, or employee acting in that capacity or by volunteers acting under the organization's direction or supervision. Communications made by an organization include communications the creation or distribution of which is paid for by the organization or that are made in an official publication of the organization (including statements or material posted by the organization on its Web site), as part of the program at an official function of the organization, by an officer or director acting in that capacity, or by an employee, volunteer, or other representative authorized to communicate on behalf of the organization and acting in that capacity.

(D) *Special rule regarding contributions to section 501(c) organizations*. For purposes of paragraph (a)(2)(iii)(A)(4) of this section, a contribution to an organization described in section 501(c) will not be treated as a contribution to an organization engaged in candidate-related political activity if—

(1) The contributor organization obtains a written representation from an authorized officer of the recipient organization stating that the recipient organization does not engage in such activity (and the contributor organization does not know or have reason to know that the representation is inaccurate or unreliable); and

(2) The contribution is subject to a written restriction that it not be used for candidate-related political activity within the meaning of this paragraph (a)(2)(iii).