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POLITICAL CAMPAIGN ACTIVITY AND EXEMPT ORGANIZATIONS

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The IRS and the Federal Election Commission (FEC) regulate the political activities of tax-exempt organizations. In this article, the authors review the IRS's and FEC's rules and how they apply to different types of exempt organizations, and discuss ways that interested nonprofits can legally and effectively participate in elections, including by using 527 organizations as part of their political engagement.

The contentious and expensive 2020 elections are behind us. Tax-exempt organizations were very involved throughout the process, spending almost $3 billion on political advertisements during the election cycle. And while there are some states – we see you New Jersey and Virginia – that have significant statewide elections coming up in November 2021, most of the country should have a respite from incessant political ads. At least for a short while.

For tax-exempt organizations that are interested in the political process, this temporary break during the "off-year" provides an opportunity for them to reflect on their activities and to assess how best to position themselves to participate in the 2022 election cycle and beyond.

The IRS and the Federal Election Commission (FEC) regulate the political activities of tax-exempt organizations.[1] 501(c)(3) organizations are prohibited from engaging in any political campaign activity, while other types of tax-exempt organizations – such as 501(c)(4) social welfare organizations and 501(c)(6) business leagues – are permitted to engage in a limited amount of political campaigning.

On the other extreme are 527 political organizations (typically political action committees (PACs) and Super PACs), whose primary purpose is to engage in partisan activities. The vast majority of political spending is done by these 527s; however, 501(c)(4)s and 501(c)(6)s have spent on average around $200 million during each election cycle for the past decade.

In this article, we will review the IRS's and FEC's rules and how they apply to different types of exempt organizations, and discuss ways that interested nonprofits can legally and effectively participate in elections, including by using 527s as part of their political engagement.

Overview

All 501(c) tax-exempt organizations are subject to IRS restrictions on their political activity. 501(c)(3) organizations are absolutely prohibited from participating or intervening "directly or indirectly in any political campaign on behalf of or in opposition to any candidate for public office."[2] 501(c)(4) organizations, on the other hand, can engage in political activity so long as it is not the organization's "primary" activity.[3]

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Thus, the IRS rule for 501(c)(3)s seems to be pretty straightforward: they cannot do politics. But determining whether an activity is "politics" is not always easy, and will depend on all relevant facts and circumstances. 501(c)(4)s also are subject to a facts and circumstances test, and they have something else to figure out: what "primary" means. This article will discuss these issues.

There are tax consequences to exempt organizations that engage in political activity: 501(c)(3)s can lose their tax-exempt status if they do any politicking; 501(c)(4)s are subject to taxes on their political expenditures, and if they cross over the "primary" line they could lose their (c)(4) status and potentially be classified as a political committee for FEC purposes.[4]

501(c)(3) organizations are absolutely prohibited from participating or intervening "directly or indirectly in any political campaign on behalf of or in opposition to any candidate for public office." 501(c)(4) organizations, on the other hand, can engage in political activity so long as it is not the organization's "primary" activity.

With respect to the FEC, federal campaign finance laws apply equally to all corporations – for-profit and nonprofit alike. In general, and with a number of exceptions that will be discussed below, a corporation may not use its corporate resources to make direct contributions in connection with federal elections. So while a 501(c)(4) can engage in substantial (though not primary) political activities under the IRS's rules, they nevertheless must comply with the FEC's rules. Thus, these organizations get the joy of being regulated by both the IRS and the FEC.

What is political activity?

The IRS has issued separate, but related, guidance on what constitutes political activity for 501(c)(3) and 501(c)(4) organizations.

501(c)(3)s. In Revenue Ruling 2007-41, the IRS confirmed that 501(c)(3)s are permitted to take positions on public policy issues, including issues that divide candidates in an election for public office; but they must take care to avoid making any statements that support or oppose a political candidate. Given the current partisan environment – where Republicans and Democrats often separate themselves into clearly established sides of an issue – that can be a difficult needle to thread.

Below are the factors that the IRS will look at in determining whether a communication by a 501(c)(3) (whether in the form of a digital, print, or broadcast advertisement, a post on the organization's website or social media accounts, or a newsletter distributed to donors) is political:

- Whether the statement identifies one or more candidates for a given public office.
- Whether the statement expresses approval or disapproval for one or more candidates' positions and/or actions.
- Whether the statement is delivered close in time to the election.
- Whether the statement makes reference to voting or an election.
- Whether the issue addressed in the communication has been raised as an issue distinguishing candidates for a given office.
- Whether the communication is part of an ongoing series of communications by the organization on the same issue that are made independent of the timing of any election.
- Whether the timing of the communication and identification of the candidate are related to a non-electoral event.

For 501(c)(3)s, the tension generally is how to educate the public on matters that are important to the organization without running afoul of the political prohibition in light of the above relatively vague factors. In addition, 501(c)(3) organizations may participate in voter and election-related activities, such as publishing voter guides, incumbent voting records, or candidate questionnaires, hosting candidate forums, or engaging in voter registration and get-out-the-vote efforts, so long as those activities are conducted in a nonpartisan manner.

501(c)(4)s and 501(c)(6)s. For other 501(c) organizations, there can be a similar tension between "education" and "political" activities; but the more common situation is distinguishing between advocacy activities (including lobbying) and political activities. Unlike 501(c)(3)s – which may only do a limited about of lobbying – 501(c)(4)s and 501(c)(6)s can engage in unlimited lobbying and often are organized and operated for the express purpose of advocating on issues that are important to the public and/or the organization's members. Many of those issues are entrenched in the ongoing debates that political parties and candidates have with each other in the lead up to an election, which can make it challenging to differentiate between

an advocacy communication and a political communication.

In Revenue Ruling 2004-6, the IRS indicated that it will look at the following factors in analyzing these communications:

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

How to apply these factors. The above rulings are quite similar, and the IRS has not issued much guidance on how they will apply these factors. But these factors can be broken down into three general categories that should be considered by an exempt organization before they hit the publish or send button: (1) content, (2) timing, and (3) distribution.

For *content*, a nonprofit organization should review the text of a written communication, the audio of a radio ad, and the video, audio, and on-screen text of a digital or broadcast ad. Obviously, if the ad mentions by name – or includes an image of – a candidate, there will be heightened scrutiny on the message of the ad. While all of the facts and circumstances will be taken into account, the content of a communication is paramount. Generally, if a reasonable reader or viewer would interpret the content of the ad to be a clear statement of support or opposition for a candidate, it likely will be treated as political activity even without regard to the timing or distribution of the ad.

For *timing*, it follows that the further away the communication is from an election, the less likely it is that it will be considered a political ad. There are no objective standards or safe harbors, but anything that is run within three months of a primary election or six months of a general election would increase the likelihood that it will be considered political.[5] However, if there is a non-electoral event that is relevant to the issue (most often this would be the case if there is an upcoming legislative vote or executive action being considered), an organization likely will have more leeway to educate or advocate on that issue.

In Revenue Ruling 2007-41, the IRS confirmed that 501(c)(3)s are permitted to take positions on public policy issues, including issues that divide candidates in an election for public office; but they must take care to avoid making any statements that support or oppose a political candidate.

Finally – and this is something that nonprofits can take action on now to put themselves in a better position for 2022 – if an organization has a track record of making similar communications outside of election season, it is more likely that they will be able to continue making those same communications during campaign season. So if there are politically-sensitive issues that an organization is passionate about, it may want to generate ads during this "off-year" to help support a position that those ads should not be considered political. If, on the other hand, a 501(c) were to produce an ad that is a "close call" for the first time in an election year, it is less likely to get the benefit of the doubt that the ad is being run for issue or educational (i.e., non-political) reasons.

For *distribution*, using modern technology exempt organizations now have the ability to micro-target their messages to their preferred audience, whether that be to a particular demographic that is most likely to think favorably of the communi-

1 Tax exempt organizations engaged in political activity at the state level are regulated by state campaign finance laws. This article does not tackle state law, but before engaging in political activity at the state level, any nonprofit should educate itself about the state rules.

2 Reg. 1.501(c)(3)-1(c)(3)(iii).

3 Reg. 1.501(c)(4)-1(a)(2)(ii). 501(c)(6)s generally are subject to the same rules on political activity as are 501(c)(4)s; in this article, when we reference 501(c)(4) organizations that should be read to include 501(c)(6) organizations.

4 This can be a dire result for a 501(c)(4) organization, particularly one that is concerned with the confidentiality of its donors. Under current law, the identity of donors to 501(c)(4)s are not publicly available; however, donors to a political committee must be publicly reported to the FEC.

5 These are longer than the 30-day / 60-day timelines for reporting electioneering communications to the FEC (as discussed below). The IRS's view of what constitutes political campaign activity generally is much broader and less precise than that of the FEC. Thus, even if a communication is not reportable to the FEC (because it falls outside the FEC's timeline for electioneering communications or does not meet the definition of "express advocacy") it nevertheless may be considered political by the IRS, which is why extra care (and extra time) should be taken.

cation, a list of donors that is most likely to contribute, or a geographic area that is most affected by a particular issue. In deciding how and where to distribute an issue or educational ad that could be considered political, a nonprofit should base its decision on objective non-partisan reasons.

For example, some exempt organizations will conduct polls or surveys on an issue, and will use the results of those studies to determine how and where to target their communications. In contrast, if an ad is targeted to a district because the issue is relevant to a contested election there, it is more likely to be considered political.

Unlike 501(c)(3)s – which may only do a limited about of lobbying – 501(c)(4)s and 501(c)(6)s can engage in unlimited lobbying and often are organized and operated for the express purpose of advocating on issues that are important to the public and/or the organization's members.

What does "primary" mean?

For 501(c)(3) organizations, the only inquiry is whether a communication is political. And the answer always should be "no". 501(c)(4)s, on the other hand, not only need to determine how to classify an activity, but they also must track the amount of their political activities to ensure that they do not constitute the organization's "primary" activity.

As is the case with most things in this area, there is not an objective standard or safe harbor for determining what the IRS means by "primary". A dictionary definition of primary is "of first rank, importance, or value," so one might argue that as long as a 501(c)(4) spends at least 50% of its budget on non-political social welfare activities, it is in the clear. However, that is an aggressive position to take.

We think it is best that 501(c)(4)s spend no more than 40% of their budget on political activities for a few reasons. First, it arguably provides some wiggle-room in the event that any of the activities that the organization classifies as issue advocacy turn out to be political campaigning. Given the subjective nature of the factors described above, it is not hard to imagine the IRS reaching a different conclusion than the organization with respect to some activities.

Second, the IRS may consider things other than an organization's expenses (such as time spent by volunteers) when evaluating a 501(c)(4)'s primary activity. Third, a decade or so ago, the IRS was embroiled in some controversy over its review (some said targeting) of the tax-exempt applications submitted by certain 501(c)(4) organizations that admittedly were engaging in some political campaign activities. Partially in response to that situation, the IRS introduced an optional expedited process for reviewing these applications, in which tax-exemption would be granted automatically for pending applications so long as the 501(c)(4) certified that it would spend no more than 40% of its expenditures and time on political campaign activity.

While that process was very limited in time and scope and cannot be relied upon by other organizations as official IRS guidance, it is one of the few times that the IRS was willing to establish an objective standard on this issue. To be sure, we are not aware of any instance in which the IRS has blessed 50% as the appropriate standard.

Federal campaign finance law

In addition to IRS considerations, a politically active 501(c) organization is subject to regulation by the FEC. A nonprofit corporation may not contribute its funds directly to (or use its resources to facilitate contributions to) political candidates, or to political parties or political committees registered with the FEC.

There are exceptions to these general FEC prohibitions. A nonprofit corporation is permitted to operate a PAC, engage in certain political activities (communications and fundraising events) with the organization's "restricted class," and make electioneering communications and independent expenditures.

PAC/restricted class. A PAC is a separate legal entity "connected" to the nonprofit, which has its own bank account into which a corporation can solicit contributions of up to $5,000 from certain eligible persons, known as the "restricted class," and makes contributions to federal candidates, political parties, and political committees. A nonprofit's corporate resources may be used to establish, fundraise for, and administer a PAC.

A nonprofit corporation's restricted class includes certain high-level employees and members. A nonprofit corporation may use its resources to communicate campaign support – including fundraising support – to its "restricted class." A nonprofit corporation also may use corporate funds and resources to host an event for a candidate to which only the "restricted class" is invited. Any other use of a nonprofit corporation's resources

to support a political campaign (such as facilities, catering, transportation, employee time) generally must be paid for by or on behalf of the candidate's campaign.

In addition to restricting a nonprofit corporation's ability to use its resources to support a political candidate, the FEC also regulates a nonprofit's political speech.

Electioneering communications. 501(c)(4) organizations may make "electioneering communications" (ECs), but these can be particularly vexing to a nonprofit organization which does not engage in any other activities that would require it to disclose its donors to either the IRS or the FEC. As a result, the FEC's EC regulations can thwart a nonprofit's ability (or at least its interest) in speaking about legislation because of these disclosure rules.

An EC is a broadcast, cable, or satellite communication made within 30 days of a primary election or within 60 days of a general election which mentions a candidate and is "targeted" to the relevant electorate. For example, a nonprofit whose sole mission is to advocate for lower taxes may want to run ads leading up to a vote on a major tax bill. The nonprofit might want an ad to say simply "Call Congressman Smith and tell him to vote against higher taxes" and for the ad to air in Congressman's Smith's district one week before the vote on the tax bill.

How can this be a problem? If it turns out the vote on the bill is scheduled three weeks before Congressman's Smith primary election, this communication, which is central to the nonprofit's mission and not intended to affect an election, nevertheless would be an EC. As such, under the FEC rules, the nonprofit would be required to identify its donors whose contributions exceeded $200 in the calendar year which were earmarked for the purpose of funding any ECs, including the one mentioning Congressman Smith [the EC]. Moreover, these ECs also must carry specific disclaimers.

Independent expenditures. 501(c)(4) organizations also may make "independent expenditures" (IEs). IEs are funds spent by a corporation for a public communication[6] that "expressly advocates" the election or defeat of a federal candidate. These expenditures may not be coordinated with political candidates or parties, must be reported to the FEC, and must include certain disclaimer information. Unlike electioneering communications, IEs apply to *all* public communications made by an organization except for those that qualify for the Internet exemption.

A statement will be considered "express advocacy" if it contains certain buzzwords – "vote," "elect," or "reject" – but also if the statement "could only be interpreted by a reasonable person as containing advocacy of the election or defeat" of a candidate.[7] So "Vote for Congressman Smith, he understands that high taxes are bad for America" would be an IE, but so would an ad run close in time to an election that says "Congressman Jones believes that raising your taxes is a good thing; we would be better off without him". IEs also are subject to specific disclaimers. Further, IE disclosure is more onerous than that for ECs and has been the subject of intense litigation.

For 501(c)(3) organizations, the only inquiry is whether a communication is political. 501(c)(4)s, on the other hand, not only need to determine how to classify an activity, but they also must track the amount of their political activities to ensure that they do not constitute the organization's "primary" activity.

As things stand today, nonprofits that make IEs must disclose contributors who give more than $200 (inclusive of all donations made in the calendar year) made during the reporting period in which the IE was made. As a result, IEs by nonprofits have become particularly disfavored. Thus, it is imperative that nonprofits be aware of the current disclosure requirements for IEs prior to engaging in FEC reportable political activity.

Finally, it is very important from an FEC perspective that a nonprofit's political activity not become its "primary purpose." Just like the IRS, the FEC has not defined "primary purpose," but the FEC will take account of public statements made by the organization when evaluating its purpose. For example, if the organization says in any of its communications that its main purpose is to elect candidates or engage in political activity (which should never be the case for a 501(c)(4) organization), the FEC will take notice and may

6 52 U.S.C. section 30101(22) defines a public communication as "a communication by means of any broadcast, cable, or satellite communication, newspaper, magazine, outdoor advertising facility, mass mailing, or telephone bank to the general public, or any other form of general public political advertising," but does not explicitly include the Internet. However, 11 CFR 100.26 states that "general public political advertising shall not include communications over the Internet, except for communications placed for a fee on another person's Web site." This has become known as the "Internet exemption."

7 11 CFR 100.22.

deem the nonprofit to be a political committee even if the nonprofit keeps its spending below the 40% threshold.

Affiliated organizations

Finally, we will briefly touch on how tax-exempt organizations can structure themselves in order to have flexibility to engage in a broad range of activities in compliance with IRS and FEC requirements.

A common arrangement is for there to be three affiliated organizations with the common goal of advancing a particular issue or cause: (1) a 501(c)(3) that educates the public on the issue, (2) a related 501(c)(4) that advocates to enact legislation and policies that advance the issue, and (3) a 527 (PAC) that supports candidates that are aligned with the group's position on the issue. As discussed above, a 501(c)(3) is not permitted to establish a PAC directly, so instead the 501(c)(3) and 501(c)(4) can be structured as brother-sister (or parent-child) organizations, and the PAC can be established as a subsidiary of the 501(c)(4).

With this type of structure, it is important that the three organizations operate as separate legal entities. Since 501(c)(3)s are not permitted to engage in any political activities (and, while not discussed in this article, also are limited in the amount of lobbying that they can do), 501(c)(4)s have limits on their political activity, and PACs can suffer negative consequences if they do anything other than politics, the organizations would need to exercise care and diligence to ensure that the activities of one are not attributed to any of the others.

At a minimum, the organization should observe corporate formalities, such as maintaining independent books, records, and bank accounts, and holding separate board meetings. There can be some overlap in the management (directors and officers) of the organizations, but it is recommended that there be at least some independent directors on each entity.

In addition, the organizations may share resources (such as office space, employees, intellectual property, etc.); in which case there should be a cost-sharing agreement in place whereby the organiza-

tions can allocate expenses in order to minimize the risk that the activities of any one organization will be attributed to another. In particular, given the absolute prohibition on 501(c)(3) political activity, it is critical that no (c)(3) resources be used to subsidize the political activities of the other organizations.

Conclusion

An exempt organization that wants to participate in policy matters, and especially one that participates (or wants to participate) in the political process, needs to be aware of the various IRS and FEC rules at play. The last thing any nonprofit wants is to lose its exempt status or be re-classified as a political committee. However, with nearly $3 billion spent in the last cycle, it is clear that many nonprofits are and will continue to be involved in elections.

To stay on the right side of the line, a tax-exempt organization should (in addition to reading this article):

- Educate its employees on the IRS and FEC definitions regarding political activity, what type of activities are – and are not – permitted, and the implications of these activities (tax consequences, filing and disclosure obligations, etc.).
- Closely review, monitor, and document public communications (advertisements, donor/member newsletters and emails, websites, social media, publications, etc.), including preparing and retaining documents that show (if applicable) why the content, timing, and distribution of the communication is non-partisan.
- If the organization does engage in political activities, it will need to track those expenses (to distinguish between political and non-political expenses), since those expenses will need to be reported and potentially will be subject to tax.
- If a nonprofit makes a grant to another exempt organization and wants to be sure that it can properly classify and account for the grant (as educational, lobbying, political, etc.), the grantor should conduct diligence on the grantee, and the parties should sign a grant letter agreement detailing the permitted use of the grant funds.
- If a nonprofit wants to engage in different types of activities (educational/charitable programs, issue advocacy, and/or influencing elections) in order to further its mission or better accomplish its goals, it should consider establishing affiliated organizations to conduct these separate activities. ■

In addition to IRS considerations, a politically active 501(c) organization is subject to regulation by the Federal Election Commission (FEC).