

Rules for Exempt Organizations During an Election Year

[BOBBY]

Good morning (afternoon). Welcome to Exempt Organization's phone forum on "Rules for Exempt Organizations During an Election Year."

Making today's presentation are: Judith Kindell, senior technical advisor to the Director of Exempt Organizations; and Justin Lowe, a tax law specialist in EO Rulings and Agreements in Washington, DC.

Each of you should have received the power point slides that our speakers will follow. If you printed the slides or if you have them up on your computer, follow along as Judy and Justin deliver their presentations. They'll let you know what slide they're on as they proceed.

In preparation for today's presentation, we solicited your questions on this topic. Asking for your questions in advance allows us to address those that are relevant to the group as a whole. Toward the end of today's presentation, our speakers will address each of those questions.

Let's begin. Justin?

[JUSTIN]

Good morning (afternoon). Our session today is about political campaign, lobbying and general advocacy and the tax law concerning those activities for various types of tax-exempt organizations. We'll first provide some background on the different types of tax-exempt organizations we will discuss today as well as a quick summary of the rules for each organization; next, we will talk about the various types of advocacy activities; and finally, we will describe specific rules concerning advocacy activities for these organizations as well as discussing what the IRS has been doing and will be doing to promote compliance and enforce the rules in this area.

[Slide 2]

As shown in Slide Number Two, we are going to discuss five separate types of tax-exempt organizations today and we will refer to them by the sections of the Internal Revenue Code that they are organized under. Each of these types of organization has a different purpose and requirements. These are the types of tax-exempt organizations we most frequently see engaging in advocacy activities. However, there are many

other types of tax-exempt organizations and some of them may also engage in advocacy activities. It is important to understand the requirements for the specific Code section that the particular organization qualifies for exemption under. For today, we will focus on these particular types of exempt organizations, the section 501(c)(3) charitable organizations, the section 501(c)(4) social welfare organizations, the section 501(c)(5) labor, agricultural and horticultural organizations, the section 501(c)(6) business leagues, and the section 527 political organizations.

[Slide 3]

The first type of organization is the section 501(c)(3) charitable organization as discussed on Slide 3. These are the organizations that most people think of when they think of non-profit or tax-exempt organizations.

Charitable organizations must be organized and operated *exclusively* for one of the exempt purposes set out in section 501(c)(3) of the Internal Revenue Code. These can include charitable, religious, educational, scientific, and other purposes. Churches, schools, hospitals, homeless shelters, and museums are among the many charitable organizations qualifying for tax-exempt status. Note that a charitable organization does

not need to be a school to qualify as educational under section 501(c)(3), it may be an organization that educates the public about issues. This will come up again later in our discussion.

A primary benefit to qualifying as a section 501(c)(3) organization is that in addition to being exempt from federal income tax on its income (including investment income), these organizations are also eligible to receive tax deductible charitable contributions. Judy, why don't you tell us about the next group of organizations.

[JUDY]

[Slide 4]

Thank you, Justin. Although the next group of tax-exempt organizations each have their own separate requirements for exemption, they share important characteristics so we will generally be discussing them as a group. Turning to Slide 4, we will begin with the section 501(c)(4) social welfare organizations. Section 501(c)(4) organizations must be organized as a non-profit organization and must be operated exclusively for the promotion of social welfare. This includes promoting the common good as well as the general welfare of the people in a particular community.

Organizations qualifying as section 501(c)(4) organizations range from community pools to HMOs, but, of more relevance here, also include issue oriented organizations.

[Slide 5]

The second type of tax-exempt organization in this group is discussed on Slide 5: the section 501(c)(5) organization or labor, agricultural or horticultural organization. They must be operated to better the conditions of people engaged in a particular pursuit. However, the earnings of these organizations cannot inure to the benefit of the organizations' members. This means that the organization's income must go towards benefiting the members' circumstances in general, it cannot be distributed directly to the members. Unions, farm bureaus, and breeding associations are all examples of section 501(c)(5) organizations.

[Slide 6]

Slide 6 brings us to the last in this group of tax-exempt organizations – the section 501(c)(6) business leagues. Section 501(c)(6) organizations are associations of persons who have a common business interest and which promote that common interest. However, these organizations may not

conduct a regular trade or business for profit. Rather, they must engage in activities that promote the common interest of their members, in this case business interests. Chambers of commerce, trade associations, and real estate boards are all examples of section 501(c)(6) organizations.

As I mentioned earlier, these three types of tax-exempt organizations share common characteristics so we will discuss these organizations as a group. Like the charities, they are exempt from federal income tax on their income (including investment income), but they are not eligible to receive tax deductible charitable contributions. However, in some instances, their members may deduct dues payments as a business expense. Now, I will let Justin tell you about the last type of exempt organization.

[JUSTIN]

[Slide 7]

The last type of organization we will discuss is the political organization under section 527 on Slide 7. These must be organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures to influence the selection, nomination, election or appointment of any individual to Federal, State, or local public office, office

in a political party, or Presidential and Vice-Presidential electors. While some of you may have heard of section 527 organizations as a particular type of organization not subject to federal election law, in fact this Code section provides for the tax treatment of all political organizations. This includes candidate committees, political parties and political action committees (or PACs) that report to federal or state election authorities. While these are tax-exempt organizations, the exemption from income tax is more limited than the other organizations we discussed because certain income, such as investment income, remains subject to income tax. Furthermore, contributions to section 527 organizations are not tax deductible.

Now that you have some background on the five types of tax-exempt organizations we will be discussing today, let's turn to advocacy. Advocacy can take a variety of forms. For the people concerned with a particular issue, they may not care about the form of their advocacy – just whether they are effective in achieving their ultimate goal. The Internal Revenue Code, however, does distinguish between types of advocacy activities and provides for differing tax consequences, so it is important to understand these differences.

[Slide 8]

We will start with Slide 8 and political campaign activity. Political campaign activity includes any activities that favor or oppose a candidate for public office. This includes obvious things like endorsing a candidate or making contributions to the candidate or a political committee, but it can also include general statements of support or opposition to a candidate.

Note that section 501(c)(3) specifically mentions publishing and *distributing* statements, so political campaign activity includes distributing material that favors or opposes a candidate that is prepared by others. Whether an organization has engaged in political campaign activity depends upon all of the facts and circumstances. For federal income tax purposes, political campaign activity concerns candidate elections. Unlike some state election laws, it generally does not include activity concerning ballot measure initiatives, even though they may be voted on in the same election as candidates. For that, we will turn to Slide 9 and the next form of advocacy to be discussed – lobbying.

[Slide 9]

Lobbying includes any attempts to influence specific pieces of legislation. Legislation includes action by Congress, or by a state legislature or local council, with respect to acts, bills, resolutions, or similar items, including legislative confirmation of appointive office. It also includes action taken by the public in referenda, ballot initiatives, constitutional amendments, or similar procedures.

An organization will be regarded as attempting to influence legislation if it contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting, or opposing legislation, or if the organization advocates the adoption or rejection of legislation. So although lobbying is something that we typically think of as in the political realm, it is not political campaign activity because none of these activities involve a political campaign by a candidate running for public office. Additionally, because for federal income tax purposes lobbying is attempting to influence legislation, it does not include many activities that are considered lobbying in a more traditional sense, such as lobbying executive branch officials on administrative matters, such as regulations.

Remember that in order for an activity to be lobbying, it must relate to specific legislation (which includes legislative proposals). If it does not, it could be general advocacy.

[Slide 10]

Slide 10 describes what we mean when we are talking about general advocacy – which is basically all other advocacy. General advocacy consists of trying to influence public opinion on issues. Contrast this with political campaign activity, which attempts to influence opinion about candidates, and lobbying, which attempts to influence opinion about legislation. General advocacy can also include attempts to influence non-legislative parts of the government such as the executive branch or regulators.

[JUDY]

We have also included encouraging voter participation in our discussion of general advocacy. Unlike other types of advocacy where the organization advocates a position on an issue, piece of legislation or candidate, here the organization is attempting to convince people to vote, without regard to how

they vote. They can do this through a variety of means: voter registration, get-out-the-vote drives, voter guides and candidate debates are some of the methods used.

Now, having discussed the types of tax-exempt organizations and the forms of advocacy, let's put them together.

[Slide 11]

As before, we will start on Slide 11 with the section 501(c)(3) charitable organizations. Section 501(c)(3) organizations are absolutely prohibited from engaging in political campaign activity. It is important to note that this prohibition is a requirement imposed by Congress for the privilege of being recognized as exempt from federal income tax as a section 501(c)(3) organization eligible to receive tax-deductible charitable contributions.

Section 501(c)(3) organizations may engage in a limited amount of lobbying activity, but this cannot be a substantial activity of the organization. These organizations can choose between two tests of what is "substantial." One test, the "expenditure test," is based solely on the amount of money an organization spends for lobbying. The test sets out a

sliding scale of permissible expenditures based on the organization's exempt purpose expenditures, with total lobbying capped at 1 million dollars. The other test, the "substantial part test" looks at all the activities of the organization, including monetary expenditures and volunteer activity on behalf of the organization.

Finally, section 501(c)(3) organizations are permitted to engage in general advocacy about their issues when it consists of educational activity because "educational" is one of the accepted purposes and activities listed in section 501(c)(3).

[Slide 12]

As discussed earlier, section 501(c)(4), 501(c)(5) and 501(c)(6) organizations share common characteristics, including how the various forms of advocacy are treated, as highlighted on Slide 12. They can engage in a limited amount of political campaign activity provided that activity, along with any other non-exempt activity, is not their primary activity. Their primary (or sole) activity can be lobbying activity, so long as it is related to their exempt purpose. Finally, like the section 501(c)(3)

organizations, they can engage in unlimited general advocacy that is related to their exempt purpose.

[Slide 13]

Finishing up with the section 527 organizations on Slide 13, the exempt purpose of section 527 organizations is attempting to influence elections, so they can engage in unlimited political campaign activity – that is what they do. All other activities, including lobbying and general advocacy are limited. To the extent a section 527 organization makes more than insubstantial non-exempt purpose expenditures from any fund, there are tax consequences for the organization.

That is our general overview of the area. As you can see, it is possible to engage all forms of advocacy in some type of tax-exempt organization, it just has to be the correct type of tax-exempt organization. Because of this, issue oriented groups will frequently set up an affiliated structure with a section 501(c)(3) charitable organization to engage in educational issue advocacy, a section 501(c)(4) social welfare organization to lobby on the issue and a section 527 political organization to influence candidate elections.

Now, Justin will take us a little more in depth to discuss some of the issues that arise in this area, beginning with the section 501(c)(3) charitable organizations.

[JUSTIN]

[Slide 14]

Thank you. As Judy discussed, section 501(c)(3) organizations are prohibited from engaging in any political campaign activity. However, that does not mean that they can have no role in the election process. As noted on Slide 14, the current language applicable to section 501(c)(3) organizations reads, "...[an organization] 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." Thus, the section 501(c)(3) organization may not engage in any activities that support or oppose any candidates. That does leave open other options that do not involve favoring or opposing candidates.

Remember that advocating for or against ballot initiatives is not political campaign activity, it is lobbying. Thus, section 501(c)(3) organizations can

engage in a small amount of this activity. However, lobbying activity, including on ballot initiatives, must be an insubstantial part of their activities.

Also, remember that section 501(c)(3) organizations can participate in the electoral process by educating voters, registering voters, or encouraging higher voter turnout at the polls. These kinds of activities are legitimate, permissible activities of a section 501(c)(3) organization as long as they are carried out in a non-biased manner. Thus, there is a role that a section 501(c)(3) organization may play in the election process, making it important that all facts and circumstances be considered to determine whether a section 501(c)(3) organization has intervened in a political campaign or has engaged in an allowable activity.

[Slide 15]

Taking this into account, let's turn to Slide 15 and look at what the IRS has done in this area. In 2004, we noticed a growth in the number and variety of allegations of prohibited political campaign intervention by section 501(c)(3) organizations. This increase in allegations, coupled with the dramatic increases in spending overall during political campaigns,

raised concerns about whether prohibited funding and activity were becoming an emerging non-compliance problem among section 501(c)(3) organizations. Therefore, the IRS initiated the Political Activities Compliance Initiative (or PACI, as we call it) to respond in a faster, targeted fashion to specific credible allegations of political campaign intervention.

As part of the initiative, a “fast track” process was implemented during federal election cycles for evaluating allegations – we call them “referrals” – of potential prohibited political campaign activity by section 501(c)(3) organizations and for starting examinations, where appropriate. Referrals come to the IRS from many sources. Each week, a committee of three experienced, career civil service employees review the referrals received and decide whether they merit examination. In addition, all of the church cases go through the specific procedures of section 7611, which require a church tax inquiry prior to the opening of a church tax examination. Under this section of the law, the approval of the Director, EO Examinations is required before the initiation of any contact with a church.

This “fast track” process has been used for the 2004, 2006 and now the 2008 federal election cycles. Because allegations of political campaign

intervention are particularly time sensitive due to the elections, this process enables the IRS to contact organizations and attempt to resolve any issues in a timely fashion. For the 2004 and 2006 election cycles, approximately half of the over 400 referrals received were determined to merit examination.

For 2006 and 2008, we have expanded PACI program to include a sub-project – PACI-PC (for political contributions). Under federal and state election law, there is a wealth of information available concerning campaign finance disclosures. In addition to evaluating allegations, we have also begun reviewing the public disclosures of political committees in order to determine whether section 501(c)(3) organizations have made contributions to them. We then contact the organization and attempt to resolve this issue.

Our activities are not limited to enforcement actions, we have also issued guidance in this area, and Judy will tell you a little more about that.

[JUDY]

An important component of the PACI program has been educating the public and section 501(c)(3) organizations about the political campaign intervention prohibition. Over the years, we have issued news releases, posted information on our website at www.irs.gov/eo, spoken at conferences and forums such as this one concerning the prohibition. In 2006, we issued Fact Sheet 2006-17 as a plain language overview of the political campaign prohibition for section 501(c)(3) organizations. The fact sheet included 21 examples illustrating the application of the prohibition on political campaign intervention along with some of the factors to be considered in determining whether a section 501(c)(3) organization has intervened in a political campaign. The fact sheet was favorably received, but a number of lawyers complained that the fact sheet had no precedential value – they could not cite it in legal briefs. So last year, we released Revenue Ruling 2007-41 which converted the 21 examples into a formal document that can be cited as precedence. Because of the nature of a revenue ruling, some of the plain language discussion contained in Fact Sheet 2006-17 does not appear in the revenue ruling, in some instances because there were no examples associated with the discussion or the discussion consisted of advice to the organization. Therefore, an

organization may want to look at both documents. The 21 examples in the fact sheet and revenue ruling cover a wide range of activities that may impact on the electoral process, including voter registration, candidate appearances, issue advocacy and internet issues.

In April, we released a program letter from Lois Lerner outlining our goals for the 2008 PACI program. In addition to continuing our efforts to educate the public concerning the tax law in this area, we will continue enforcement activities in this area, focusing on allegations of more egregious violations. The follow-up steps in the letter include publishing two field service directives. One of these will focus on the need to take into account the context surrounding issue advocacy communications and voter guides and the other will provide that we will not pursue any issue involving a link from the website of a section 501(c)(3) organization to the home page of a related section 501(c)(4) organization. The program letter also indicates that we will issue a report on the PACI program by March 31 of next year – so keep your eyes open for that. These are all available at www.irs.gov/eo.

[Slide 16]

So what have we found in the PACI program? Slide 16 contains some of the more common types of prohibited political campaign activities alleged in the course of the PACI program. Alleged violations included:

- Distributing diverse printed materials that encouraged their members to vote for a preferred candidate,
- Religious leaders using the pulpit to endorse or oppose a particular candidate,
- Candidates speaking in their role as candidates at official functions of exempt organizations,
- Disseminating improper voter guides or candidate ratings,
- Placing signs on their property that show they support a particular candidate,
- Criticizing or supporting a candidate on their website or through links to another website,
- Organization officials verbally endorsing a candidate, and
- Making cash contributions to a candidate's political campaign.

[Slide 17]

What happens if a section 501(c)(3) organization engages in political campaign or lobbying activity? Slide 17 provides an overview of the possible consequences to a section 501(c)(3) organization that engages in political campaign activity or a substantial amount of lobbying. Under Section 4955, if we do find that a section 501(c)(3) organization has engage in political campaign activity that organization may be subject to tax on the amount of money it spent on the activity. In addition, the management of the organization may also be taxed if they knew the money was being spent for political campaign intervention and chose to authorize it anyway.

Sections 4911 and 4912 of the Code provide for similar taxes where a section 501(c)(3) organization conducts substantial lobbying activities. Section 4911 is the code section that applies when the organization has chosen the expenditure test, section 4912 is the code section that applies when the organization is using the substantial part test.

In addition to these possible taxes, an organization could also have its tax exempt status revoked in the event of political campaign intervention or substantial lobbying.

As Justin noted, approximately half of the referrals received in 2004 and 2006 were found to merit further examination. That determination did not mean that the IRS had determined that the organization had intervened in a political campaign. As discussed in the reports we issued in 2006 and 2007 on the PACI program, of the cases closed at that time, we found political campaign intervention in about two-thirds of the cases. Since the goal of the program is to bring section 501(c)(3) organizations into compliance, we have not revoked the tax-exempt status all of these organizations. We have only revoked or proposed revocation of tax-exempt status in egregious cases. For the remainder, we have issued the organization a “no-change letter with advisory” advising the organization that it intervened in a political campaign but not changing its tax-exempt status.

I'll now turn it over to Justin to discuss section 501(c)(4), 501(c)(5) and 501(c)(6) organizations.

[JUSTIN]

[Slide 18]

Now that we have finished our discussion of section 501(c)(3) organizations, lets quickly review the rules for section 501(c)(4), 501(c) (5) and 501(c) (6) organizations, shown on Slide 18. Their primary activity must be in furtherance of their exempt purpose, which differs for each category of organization. Lobbying can further an exempt purpose, so it is not restricted, so long as the lobbying being done actually relates to the organization's purpose and not someone else's. Political campaign activity is not in furtherance of the exempt purposes of a section 501(c)(4), 501(c)(5), or 501(c)(6) organization, however. Therefore, that activity, along with any other non-exempt purpose activity must be a less than primary activity of the organization. Nevertheless, even if exemption is not at stake, there are tax consequences for these organizations to the extent they engage in political campaign or lobbying activity.

[Slide 19]

As Slide 19 shows, these organizations will be subject to tax on the money they spend towards political campaign activities under section 527(f). They

are taxed on either their political campaign expenditures or their net investment income, whichever is less. Note that while the organization is subject to tax on all of its political campaign activity expenditures, it will not, unlike a section 501(c)(3) organization, risk losing its overall tax-exempt status unless the political campaign activities, combined with other non-exempt activities, amount to the organization's primary activities. Revenue Ruling 2004-6 illustrates the application of section 527(f).

There is another tax that may come into play, the section 6033(e) "proxy tax." Remember that while section 501(c)(4), 501(c)(5), or 501(c)(6) organizations cannot receive tax deductible charitable contributions, they may receive membership dues that are deductible as an "ordinary and necessary business expense," but only to the extent not used by the tax-exempt organization for political campaign and lobbying activities. The section 501(c)(4), 501(c)(5), or 501(c)(6) organization has the option of notifying its members of the non-deductible portion of the dues or paying a "proxy tax." For more information about the proxy tax and notice requirements, see Revenue Procedure 98-19.

[Slide 20]

Finally, before addressing your questions, we are going to briefly go over the annual information return filing requirements for exempt organizations. In general, section 501(c) organizations, including section 501(c)(3), 501(c)(4), 501(c)(5) and 501(c)(6) organizations, file an annual information return with the IRS, either Form 990, Form 990-EZ, or Form 990-N, although there are some exceptions. Certain section 527 organizations also have to file the Form 990 or Form 990-EZ. Which form an organization files depends on the size of the organization. Our website, www.irs.gov/eo, contains more details about which form to file. The annual information return is publicly disclosed. That means that the organization is required to make it available to the public. Many organizations do this by posting it on their website, if they have one. In addition, the IRS is also required to make the return publicly available.

We have recently finished significantly revising the Form 990 and as part of our effort to increase transparency, organizations will now report all of their political campaign and lobbying activity on one schedule, Schedule C.

There are other forms that tax-exempt organizations may have to file. For example, section 501(c) organizations may need to file a Form 990-T to report unrelated business income tax. The taxable income of a section 527 political organization and the tax under section 527(f) are reported on Form 1120-POL. Some political organizations have additional reporting requirements.

[Slide 21]

Now we will go over some of the questions you submitted. It may be helpful to refer to slide 21 while we go over them. That slide contains a chart which summarizes the rules we have discussed so far.

The first question deals with providing information to candidates running for public office, for example if the charitable organization is a known authority on a particular subject, and whether that would jeopardize a section 501(c)(3) organization's tax-exempt status.

In this situation, I would look to the discussion in Revenue Ruling 2007-41 concerning candidate appearances. In that context, we note that candidates may attend organization events that are open to the public

without jeopardizing the tax status of the organization. A similar analysis would be applied here. If the section 501(c)(3) charity regularly supplies the public with this type of information and a candidate requests and receives this information as would any other member of the public, the organization's tax-exempt status should not be affected. If the organization is sending information to candidates on its own initiative, it should look to the factors discussed, such as providing equal opportunities to participate and indicating no support or opposition to any candidates.

Do you want to take the next question, Judy?

[Judy]

This next question deals with the tests for lobbying of section 501(c)(3) organizations and how it is measured. As we discussed earlier, a section 501(c)(3) organization may attempt to influence legislation – or lobby – provided it is not a substantial activity of the organization and there are two tests for determining what is a substantial activity – the traditional substantial part test which looks at all facts and circumstances and the expenditure test.

An organization may use the expenditure test only if it has made an election to do so. The expenditure test only examines money spent for lobbying and sets out specific dollar amounts that are permissible, starting at 20% of exempt purpose expenditures. The percentage declines as the exempt purpose expenditures of the organization increase, but total lobbying is capped at 1 million dollars. Therefore, an organization that elects to use the expenditure test cannot spend more than 1 million dollars on lobbying, regardless of how large the organization is. Furthermore, this test distinguishes between grassroots and direct lobbying, with grassroots lobbying subject to more limitations.

All organizations that do not make (or that revoke) the election to be subject to the expenditure test are subject to the substantial part test. Under this test, the IRS looks at all of an organization's lobbying activities, including money spent and time of volunteer hours, and compares those activities to the organization's activities as a whole. While stating that there is no particular percentage, the courts have found in one case that activities that were less than 5% of an organization's activities were not substantial while in another case activities that ranged from 16 to 20% were substantial.

This next question deals with how lobbying expenditures are calculated when you have a publication that includes both general advocacy and lobbying communications.

In that case, there are specific rules in the regulations providing that lobbying costs include all parts of the communication that is on the same specific subject. Regulation 56.4911-3(b), Examples (8) and (9) illustrate the application of these rules.

[Justin]

Another question dealing with section 501(c)(3) organizations and lobbying is whether the organization can be the initiator of legislation and involved in the push to get it through the legislature.

Initiating and drafting a legislative proposal would be a lobbying activity that must be considered in determining whether the section 501(c)(3) organization has engaged in lobbying as a substantial activity. This would be lobbying whether the organization does the activity in-house or hires others, such as attorneys, to draft the legislation or otherwise support the

proposal. A section 501(c)(3) organization that is concerned about the amount of its legislative activities could establish a separate section 501(c)(4) organization that would conduct lobbying activities.

The next question is whether a section 501(c)(3) organization can take a public stand on political issues.

As we discussed earlier, a section 501(c)(3) organization may engage in unlimited general advocacy, including taking a stand on issues that are at issue in the political arena, provided the communication does not involve a lobbying communication or support or opposition of any candidate for public office.

[Judy]

The next questions deal with private foundations, a specific type of section 501(c)(3) organization. While public charities fund their activities through broad support from public and government sources, private foundations are normally funded by a very small group of people and are subject to additional restrictions.

The first question is whether private foundations have any additional requirements with respect to advocacy.

Private foundations are subject to additional requirements and restrictions on their activities in the form of an excise tax on “taxable expenditures,” including lobbying and political campaign expenditures. In addition, a foundation’s manager may be subject to the excise tax if he or she knowingly approved a taxable expenditure. Additionally, a private foundation’s ability to engage in voter registration activities is restricted.

Private foundations can fund this activity, but it needs to be carried on by a section 501(c)(3) organization in more than one election period and in at least five states, among other requirements.

The next question is whether a section 501(c)(3) private foundation can have a legislative affairs position that is not a paid lobbyist.

The private foundation is subject to the excise tax on any amounts it expends on lobbying. If it hires an individual to conduct lobbying activity, that amount is subject to the excise tax. If it hires a person to perform a

different function, such as monitoring legislative developments, that does not involve lobbying, it will not be subject to the excise tax.

[Justin]

This question deals with lobbying on ballot measures by other section 501(c) organizations, such as a section 501(c)(5) organization. In some localities, the appropriate election law requires them to set up a separate fund to conduct that ballot measure activity. What is the tax status of that fund?

As discussed earlier, a section 501(c)(5) organization may engage in lobbying without jeopardizing its tax-exempt status. However, other laws, such as election law, may impose additional restrictions. While a separate fund set up by a section 501(c)(5) organization to support or oppose candidates would qualify as a section 527 organization, a ballot measure committee would not. It could, however, be established as a separate section 501(c)(5) organization. Such an organization could, but is not required to, apply for recognition of its exempt status by filing Form 1024. It is however subject to the annual information return filing requirement – and so would have to file a Form 990, Form 990-EZ or Form 990-N.

[Judy]

The next question deals with the filing requirements of a separate fund established by a section 501(c) organization to support or oppose candidates.

A section 501(c)(4), 501(c)(5) or 501(c)(6) organization has two options when it establishes a fund to support or oppose candidates. As discussed earlier, they may intervene in political campaigns without jeopardizing their tax-exempt status so long as they have a primary activity that furthers their exempt purpose. The section 501(c) organization can create an internal fund to accomplish this, but it would be subject to tax on the amount of expenditures from that fund or its net investment income, whichever is less. The activity of the fund would be reported by the section 501(c) organization on its Form 990.

In the alternative, the organization could have the fund treated as a separate taxable entity under section 527. Section 527 does not require that a separate legal entity, such as a corporation or association, be created. Opening a bank account is sufficient. If the section 501(c)

organization chooses this option, the separate fund then looks to the filing and disclosure requirements of section 527.

If the separate fund is established as a federal PAC that reports to the Federal Election Commission as a political committee, then it is automatically tax-exempt under section 527. In that instance, it would have to file Form 1120-POL if it had taxable income, such as investment income. If it did not have taxable income, it would not be required to file Form 1120-POL, although it could file it simply to start the statute of limitations period running. Note that a federal PAC is not required to file the Form 990.

If the separate fund is established as a state PAC, the first question is whether that PAC receives or expects to receive \$25,000 or more in any taxable year. If it does not, then it is also automatically tax-exempt and subject to the same requirements as the federal PAC. If it does receive \$25,000 in any taxable year, then there are additional filing requirements. In order to be tax-exempt, the organization must electronically file Form 8871 within 24 hours of being established or within 30 days of any material change. If a state PAC had previously qualified as automatically

tax-exempt, but no longer does so, because, for example, it receives \$25,000, then it has 30 days to file Form 8871. If the Form 8871 is not filed, the fund is subject to tax on all of its income, including contributions, at the highest corporate rate: 35%. This tax would be reported on the Form 1120-POL.

The next question for a state PAC is whether it is a qualified state or local political organization (or QSLPO). To be a QSLPO, the state PAC must be limited to state or local election activity, it must be required to report to a state agency (and actually do so) the same basic information that would be reported on Form 8872, the state agency must make the report publicly available, the state PAC must make the report publicly available and no federal candidate or officeholder may control or materially participate in the direction of the organization, direct where its expenditures are to be made or solicit contributions for the organization.

If the state PAC is a QSLPO, it identifies itself as such on the Form 8871 and it is not required to file Form 8872. If the state PAC is not a QSLPO, then it will be required to file Form 8872, where the organization discloses certain information about its contributors and the payments it makes. This

form is due either monthly or semi-annually in odd-numbered years and it is due either monthly or quarterly in even-numbered years, with certain pre- and post-election reports. If the state PAC has contributions or expenditures of \$50,000 or more, this form must be filed electronically.

If the state PAC is a QSLPO, then it will be required to file Form 990 when it has gross receipts of \$100,000 or more. If the state PAC is not a QSLPO, then it will be required to file Form 990 or Form 990-EZ when it has gross receipts of \$25,000 or more. In either case, the state PAC is required to file Form 1120-POL if it has taxable income, such as investment income, like the federal PAC.

All of the information about these filing requirements and where and how to file is available on our website at www.irs.gov/polorgs. Note that this is a different page on our website.

Okay, that is the last of the questions we have time to answer.

[BOBBY]

Thank you, Judy and Justin and thank all of you for joining us today. I hope you found the presentation helpful. Later today, we will email you a confirmation of your attendance.

I encourage you to log-on to the IRS website at irs.gov/eo for a wealth of information on this topic, including access to the full PACI Report and *The Tax Guide for Churches and Religious Organizations*.

Have a good (morning)(afternoon).