

Proposed Rules May Curtail Political Activities by Nonprofit Organizations

Summary

Last week, the Internal Revenue Service (“IRS”) published [a proposed rule](#) concerning the political activities of nonprofit organizations. The proposed rule may make it significantly more difficult for certain politically active organizations to claim tax-exemption under Section 501 of the Internal Revenue Code (“Code”).

Increasing Role of 501(c)(4)s in U.S. Elections

Before 2010, most nonprofit organizations participating in U.S. elections were traditional political committees (“PACs”) that, under federal and state elections regulations, are generally required to disclose publicly all their donors and expenditures. Since 2010, however, nonprofit organizations that are *not* PACs have played an increasingly important role in U.S. elections. 501(c)(4) organizations have been particularly important in the shift, and are estimated to have spent more than \$300 million in federal elections during the 2012 cycle.

The shift in spending patterns is significant in campaign finance law primarily because non-PAC organizations are generally required to disclose publicly only their political *expenditures*—but *donors* to non-PAC organizations generally need not be identified publicly. Critics of the shift refer to non-PAC organizations as “dark money” due to the lack of transparency, while supporters frequently argue that the option of anonymous donations allows citizens to fund speech critical of politicians (especially incumbent politicians) freely and without fear of reprisal or retribution.

Current Rules Concerning Political Participation by 501(c)(4)s

Under current federal income tax rules for 501(c)(4) organizations, there is an important distinction between the “social welfare” activities (such as lobbying and public education) and activities that support or oppose candidates for elected office (“electioneering”). Currently, 501(c)(4) organizations are permitted to engage in electioneering activities, but social welfare activities must remain the organization’s “primary” purpose.

Current federal income tax rules are, however, frequently criticized for the following two reasons:

1. The distinction between social welfare and electioneering activities is, in many cases, blurry.
2. The IRS has never provided clear guidance on when an activity constitutes an organization’s “primary” purpose. Consequently, some 501(c)(4) organizations engage in extensive electioneering activities, but claim their social welfare activities are more extensive and therefore that their “primary” purpose is social welfare rather than electioneering.

Proposed Rule

The newly proposed rule would directly address the first criticism of the existing federal income tax regulations by clarifying the line between social welfare and electioneering activities—but it would not immediately address the second criticism by clearly defining when electioneering activities constitute an organization’s primary purpose.

December 3, 2013

The new rule endeavors to establish more clear cut definitions of electioneering activity conducted by a 501(c)(4) organization, by providing that a 501(c)(4) organization's electioneering activities include, among other things, any:

1. communications that clearly support or oppose the election of a candidate,
2. communications that refer to a candidate in the 30 days before a primary election,
3. communications that refer to a candidate in the 60 days before a general election,
4. expenditures that are reported to the Federal Election Commission,
5. contributions to other organizations engaging in electioneering activities,
6. voter registration or "get out the vote" activities,
7. distribution of certain voter guides or election materials, and
8. hosting of certain events in which candidates appear as part of the program.

Such activities may not constitute electioneering activities under the current rules, depending on the circumstances—but the proposed rule would categorize all such activities as electioneering going forward.

Although the currently proposed wording for the new rule would do little to address the second criticism of existing IRS regulations of the political activities of 501(c)(4) organizations (*i.e.*, that IRS regulations do not clearly define when electioneering rather than social welfare becomes an organization's "primary" purpose), the IRS stated in its notice that it wishes to explore regulatory changes on the issue and formally requested public input and proposals on such an amendment—effectively signaling that such changes may be addressed in a subsequent version of the proposed rule.

Likely Effect of the Proposed Rule

As a practical matter, the proposed rule would likely have the following effects:

1. *Political Spending by 501(c)(4) Organizations Will Be Redirected.* If the proposed rule is implemented, 501(c)(4) organizations will reallocate their funding toward activities that do not constitute electioneering under the new rule (even if the new expenditures are less "effective" politically). For example, 501(c)(4)s will spend a larger share of their dollars on advertisements more than 30 days before primary elections and more than 60 days before general elections, and more often will overtly focus on "issues" of importance to voters without specifically discussing any upcoming elections. To be sure, many 501(c)(4) organizations already take such steps to ensure their compliance with existing regulations, but the proportion of 501(c)(4) dollars spent on such activities would increase.
2. *Dollars Will Shift Away from 501(c)(4) Organizations.* Donors wish to see their dollars used effectively, so they will in some cases redirect their contributions to organizations not affected by the new rule. Donors who do not require anonymity will increasingly donate to PACs, which are unaffected by the proposed rule but publicly identify their donors. Donors who require anonymity, on the other hand, will likely donate more frequently to other forms of politically active non-PAC nonprofit organizations (such as chambers of commerce operating under Section

December 3, 2013

501(c)(6) of the Code) which are unaffected by the proposed rule and are not required to identify donors publicly. Although the likely extent of funding disruptions remains unclear, any significant disruptions may cause existing 501(c)(4) organizations to seek to redesignate themselves as operating under Sections 501(c)(5) or (6) to avoid the inefficiencies and fundraising difficulties arising under the new rule.

3. *Anonymity Will Survive*. Regardless of the disposition of the proposed rule, organizations that do not publicly identify their funding sources will continue to participate in U.S. elections. In the short- to medium-term, such participation will likely continue through a combination of 501(c)(4), (5) and (6) organizations. Even if the IRS were to ban electioneering activities conducted by nonprofit organizations (which is not contemplated in the proposed wording of the new rule), “dark money” would very likely continue to be involved in U.S. elections, although less frequently, through organizations that are not exempt from taxation. Such a prohibition would effectively increase the “cost” of anonymity by taxing transactions in which the contributor is not publicly identified—but absent additional regulations from elections officials at the Federal Election Commission or its state-level counterparts, “dark money” organizations could survive as other-than-tax-exempt organizations.

Next Steps and Anticipated Timing

The IRS will now begin collecting and considering public comments on the proposed rule, and will eventually decide whether to enact a new rule and, if so, whether the recently proposed rule should be modified before it is adopted and implemented. In any event, no new rules are expected to take effect before the 2014 election—and if any new rules are passed, litigants would likely argue that the new rules are unconstitutional and that their implementation must be delayed while constitutional challenges are heard.

Although the content and timing of any eventual rule change is unclear, it remains critical for nonprofit organizations and their funders to plan for and carefully implement any political expenditure program, and politically active organizations and their members should closely monitor the progress of the proposed rule.

This document is intended to provide you with general information regarding a proposed IRS rule concerning the political activities of nonprofit organizations. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.

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