PUBLICATION

Spotlight on Section 501(c)(3) Organizations: Lobbying and Political Activity Sanctions

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Organizations exempt under Internal Revenue Code (Code) Section 501(a) generally do not pay federal income taxes. In addition, exempt organizations recognized as such under Section 501(c)(3) -- that is, by way of example, religious, charitable, literary or educational organizations -- provide their donors with the opportunity to deduct contributions made to such organizations on their individual federal income tax returns. As with the various types of organizations exempt under Section 501(a), an organization recognized under Section 501(c)(3) has a wide range of filing, disclosure and other requirements that must be satisfied in order to maintain that status.

This Alert focuses upon the lobbying and political activity sanctions applicable to Section 501(c)(3) organizations. Those organizations must be continually vigilant through their management and governance operations to ensure that these prohibitions are not violated.

General Background

There are two important components of the political activity prohibition in regard to Section 501(c)(3) organizations, namely (i) political attempts to influence or lobby legislative acts and (ii) political attempts to promote or defeat a candidate for public office. The predecessor to Section 501(c)(3) was amended in 1934 to prohibit attempts to influence legislation. In 1954, Congress extended the prohibition to include political campaign activities. In 1976, Congress added Section 501(h) to the Code which allows limited lobbying activities by certain public charities. In 1987, Congress again amended Section 501(c)(3) to prohibit negative campaigning.

The current language of the political activity prohibition within Section 501(c)(3) mandates that such an organization "…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."

The sole sanction previously available to the IRS for a political activity violation was to revoke an organization's exempt status. However, in a manner analogous to the excise tax on excess benefit transactions (see our September 24, 2010 Alert addressing excess benefit transactions), Congress in 1987 enacted Code Sections 4912, 4955, 6852 and 7409. Under those Sections, the Service may, in appropriate circumstances, impose monetary sanctions on an organization that violates the political activity rules, without revoking the organization's exempt status.

Lobbying Activities

Limited Permission. Section 501(h)(4) permits limited lobbying activities by public charities. Eligible organizations for such limited permission are the following:

Educational institutions described in Section 170(b)(1)(A)(ii);

Hospitals and medical research organizations described in Section 170(b)(1)(A)(iii);

Organizations supporting government schools, as described in Section 170(b)(1)(A)(iv);

Organizations publicly supported by charitable contributions, as described in Section 170(b)(1)(A)(vi);

Organizations publicly supported by admissions and sales, as described in Section 509(a)(2); and

Organizations supporting certain types of public charities, as described in Section 509(a)(3).

Notably, religious organizations are excluded from the protection of Section 501(h). Section 501(h) came into the Code as part of the Tax Reform Act of 1976. Excluded from the shelter of Section 501(h) are churches and private foundations. Specific reasons were not given in the drafting of that 1976 legislation for excluding those entities, but generally the sanction imposed by prior law (that is, loss of the Section 501(c)(3) exemption) was expected to continue as the applicable sanction for religious organizations.

Expenditure Limitations. An eligible organization which elects under Section 501(h) to make lobbying expenditures is limited to the lesser of $1,000,000 or the amount determined from the following table:

If the Organization's exempt purpose expenditures are:	Then the limit is:
Not over $500,000	20% of exempt purpose expenditures
Over $500,000 but less than $1,000,000	$100,000 plus 15% of excess
Over $1,000,000 but less than $1,500,000	$175,000 plus 10% of excess
Over $1,500,000	$225,000 plus 5%

Lobbying expenditures in excess of the limits set forth above are called "excess lobbying expenditures." A 25% excise tax is imposed on excess lobbying expenditures in any year. A total loss of exemption results if an organization "normally" spends more than 150% of the permissible amounts.

Tax on Disqualifying Expenditures. Section 4912 imposes a tax on disqualifying lobbying expenditures when an organization loses its exemption under Section 501(c)(3) as a result of excess lobbying expenditures. The rate of tax is 5% of the expenditures. A separate tax of 5% is imposed on an organization manager where that manager knew such expenditures would likely result in disqualification of the organization's exempt status. This separate tax on the manager does not apply if:

An election under Section 501(h) is in effect;

The organization is a church; or

The organization is a private foundation.

As in the case of loss of eligibility under Section 501(h) due to excess lobbying expenditures, churches and private foundations are subject to the same sanctions (that is, loss of exempt status) upon engaging in lobbying activities.

Political Expenditures Prohibited

Efforts to Promote/Defeat a Candidate. A Section 501(c)(3) organization that engages in political candidate activity or expenditure will risk exposure to monetary sanctions or exempt status revocation. "Political activity" is any participation in or intervention in, including the publication or distribution of statements, in a political campaign on behalf of, or in opposition to, any candidate for public office. Section 4955 authorizes the Service to levy a tax on any "political expenditure" by a Section 501(c)(3) organization. A "political expenditure" is a payment or promise to pay money to influence the selection, nomination or appointment of anyone to public office.

The initial tax on the organization is 10% of the political expenditure. There is also a 2.5% tax on managers who know that the expenditure was improper.

If the expenditure is not corrected, there is an additional tax equal to 100% of the amount of the expenditure. Correction means recovery of the expenditure, if possible, and implementation of procedures to prevent recurrence.

Treasury Regulation Section 53.4955-1 takes the position that the Section 4955 monetary sanction is a remedy available to the Service that is in addition to, rather than in place of, revocation of Section 501(c)(3) status for abuses of prohibitions on political activities.

Flagrant Violations. Section 6852 authorizes the Service to make “termination assessments” in the case of political expenditures by Section 501(c)(3) organizations which are a flagrant violation of the prohibition against political expenditures. Such an assessment, which is somewhat similar to jeopardy assessments, results in the tax payable by the organization or any manager under Section 4955 of the Code.

Section 7409 also authorizes, upon recommendation from the IRS Commissioner, a civil action to be brought in the name of the United States to seek an injunction to prevent flagrant political expenditures by Section 501(c)(3) organizations.

Fortunately, the Service in general uses these drastic remedies sparingly.

Summary

Section 501(c)(3) organizations must adhere to the numerous requirements imposed by Code, the Treasury Regulations and rulings from the Service. Lobbying and related expenditures are subject to the Service's scrutiny upon audit, and any violations of the lobbying expenditure limitations, political activity or political expenditures prohibition can result in devastating consequences to the organization. Section 501(c)(3) organizations are well advised to review the Service's pronouncements relative to lobbying activities (even if the organization is permitted to engage in limited lobbying) as well as the pronouncements pertaining to prohibited political activities prior to undertaking any action that may be considered as political -- even activities such as providing facilities for or sponsoring a public forum for candidates. Keeping current on these pronouncements by the Service is yet another due diligence checklist for upgrading the organization's management and governance credentials.

Should you have any questions regarding political activity prohibitions, or any other requirements applicable to the operations of exempt organizations, please do not hesitate to contact your Baker Donelson attorney or any attorney within the Firm's Tax Department.