

# IRS Report Regarding Use of Inappropriate Criteria to Review Exemption Applications Sheds Light on IRS's View of Political Campaign Intervention Activities

July 25, 2013

## **Background**

On June 24, 2013, the Acting Commissioner of the IRS issued an initial assessment and plan of action (the "Report") in response to the findings by the Treasury Inspector General for Tax Administration ("TIGTA") that the IRS developed and applied inappropriate criteria for reviewing tax exemption applications filed by conservative groups. TIGTA's report had concluded, in part, that this criteria resulted in substantial delays in processing certain applications and allowed unnecessary information requests to be issued.

The IRS's development and use of this criteria first came to light on May 10, 2013 during an American Bar Association conference where Exempt Organizations Division Director Lois Lerner, who is currently on administrative leave, disclosed that the IRS had selected certain conservative groups' tax exemption applications for additional review based on criteria that, among other things, flagged the use of certain terms, such as "Tea Party," in tax exemption applications.

The Report states that there were management failures on the part of the IRS, including failure to identify, prevent, address, and disclose the problematic situation that materialized with the review of tax exemption applications. The Report also agrees with TIGTA's recommendations regarding how to improve the review of tax exemption applications, including adding the development of guidance on how to "measure the 'primary activity' of I.R.C. § 501(c)(4) social welfare organizations . . . in the Department of the Treasury Priority Guidance Plan."

## **Confusion Caused by the Code and Treasury Regulations**

The Report makes a point to highlight the confusion caused by, and difficulty to enforce, current law and Treasury Regulations that apply to organizations described in Section 501(c)(4) of the Internal Revenue Code of 1986 (the "Code"), noting that the IRS is responsible for "*administering* the nation's tax laws and regulations," but that Congress is responsible for writing the laws and the Department of the Treasury is responsible for developing tax policy.

This confusion starts with Section 501(c)(4) of the Code, which provides exemption for organizations that are, among other things, “operated exclusively for the promotion of social welfare.” An organization meets this test according to the Treasury Regulations if it is “primarily engaged in promoting in some way the common good and general welfare of the people of the community,” which includes engaging in legislative lobbying. The Treasury Regulations make it clear 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,” but the Code and the Treasury Regulations do not prohibit a 501(c)(4) organization from engaging in such activities. These rules cause substantial uncertainty regarding how to determine whether an organization is “primarily” engaged in social welfare activities and where to draw the line between what is considered social welfare activities and political campaign intervention.

### **Guidance by the IRS in the Report**

The Report provides some insight to the IRS’s view of what it considers to be political campaign intervention. To help relieve the backlog of applications to be recognized as a 501(c)(4) organization, the Report provides an expedited process for those organizations that meet certain criteria related to the amount of time and expenditures spent to promote social welfare versus the amount of time and expenditures spent on direct or indirect participation or intervention in any political campaign for public office.

The Report provides that direct or indirect participation or intervention in any political campaign for public office includes any expenditure incurred or time spent by the organization on:

- Any written (printed or electronic) or oral statement supporting or opposing the election or nomination of a candidate;
- Providing financial or other support to (or soliciting such support on behalf of) any candidate, political party, political committee, or Section 527 organization;
- Conducting a voter registration drive that selects potential voters to assist on the basis of their preference for a particular candidate or party;
- Conducting a “get-out-the-vote” drive that selects potential voters to assist on the basis of their preference for a particular candidate or (in the case of general elections) a particular party;
- Distributing material prepared by a candidate, political party, political committee, or Section 527 organization; and
- Preparing and distributing a voter guide that rates favorably or unfavorably one or more candidates.

The Report also provides that solely for purposes of determining an organization’s eligibility for the expedited process, direct or indirect participation or intervention in any political campaign for public office includes any expenditure incurred or time spent by the organization on:



- Any public communication within 60 days prior to a general election or 30 days prior to a primary election that identifies a candidate in the election. For this purpose, “public communication” means a communication by means of any broadcast, cable, or satellite communication; newspaper, magazine, or other periodical (excluding any periodical distributed only to the organization’s dues paying members); outdoor advertising facility, mass mailing, or telephone bank to the general public; and communications placed for a fee on another person’s Internet website;
- Conducting an event at which only one candidate is, or candidates of only one party are, invited to speak; and
- Any grant to an organization described in Section 501(c) (other than a 501(c)(3) organization) if the recipient of the grant engages in political campaign intervention activities, unless an organization does not know whether the recipient engages in such activities and the recipient provides a representation that it will not engage in such activities.

### **Impact of the Report**

The Report serves as a reminder of the difficulty to determine whether an organization is engaging in political campaign intervention activities, especially when the organization engages in lobbying activities, which are closely-related yet subject to different tax treatment. Section 501(c)(4) organizations need to avoid engaging in too much political campaign intervention activities. And, Section 501(c)(3) organizations engaging in lobbying or similar activities should proceed with caution because of the absolute prohibition of 501(c)(3) organizations from engaging in political campaign intervention activities.

If you have any questions about the information presented in this alert, please contact your Lathrop Gage attorney or one of the attorneys listed above.