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IRS Guidelines for Political Advocacy by Exempt 501(c) Organizations: Revenue Ruling 2004-6

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Summary

IRS Revenue Ruling 2004-6 provides guidance on the definition of "exempt function" in section 527 of the Internal Revenue Code. The ruling, released in December 2003, was intended to be an election-year reminder to tax-exempt 501(c)(4), 501(c)(5), and 501(c)(6) organizations that, in addition to their responsibility to comply with campaign finance laws, they are subject to tax on certain political expenditures.[1] The ruling lists criteria that the IRS uses when determining whether an expenditure for an issue advocacy communication is taxable and provides examples.

Section 501(c) of the Internal Revenue Code describes various organizations that qualify for tax-exempt status. Under the Code, some of these organizations may participate in political campaign activity.[2] These include the organizations described in IRC §§ 501(c)(4) [social welfare organizations], 501(c)(5) [labor unions], and 501(c)(6) [trade associations]. While they may participate in such activity without risking their 501(c) status, these organizations are taxed if they make certain political expenditures.

Specifically, under IRC § 527(f), a 501(c) organization is subject to tax on any expenditure made for an "exempt function." An "exempt function" is the influencing or attempting to influence the selection, nomination, election, or appointment of an individual to a federal, state, or local public office, to an office in a political organization, or as a Presidential or Vice-Presidential elector.[3] The term "exempt function" can be confusing when talking about a 501(c) organization because the organization is not exempt from tax when it makes an expenditure for an "exempt function." It may be helpful to understand that the term "exempt function" is primarily used to describe the

[1] IRS News Release IR-2003-146.

[2] While these organizations may participate in political campaign activity under the Internal Revenue Code, they must still comply with applicable campaign finance laws.

[3] IRC § 527(e)(2).

activities that section 527 political organizations may conduct without being subject to tax. In other words, a 527 organization is exempt from tax when it makes an expenditure for an "exempt function," while a 501(c) organization is subject to tax when it makes an expenditure for an "exempt function."

The determination of whether an expenditure is for an "exempt function" is dependent on the facts and circumstances of each case. Revenue Ruling 2004-6 provides guidance in this area by presenting a **non-exhaustive** list of factors that the IRS considers in determining whether an expenditure for an issue advocacy communication is for an "exempt function." According to the ruling, factors that tend to show an expenditure for an issue advocacy communication is for an "exempt function" include:

- the communication identifies a candidate for public office,
- the communication identifies the candidate's position on the subject of the communication,
- the candidate's position has been raised (either by the communication or in other public communications) to distinguish him or her from other candidates,
- the communication is timed to coincide with an electoral campaign,
- the communication is targeted at voters in a particular election, and
- the communication is not part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.

Factors that tend to show the expenditure is not for an "exempt function" include:

- the absence of one or more of the above factors,
- the communication identifies specific legislation or an event outside the organization's control that the organization hopes to influence,
- the communication's timing coincides with a specific event outside the organization's control that it hopes to influence,
- the candidate is identified solely as a government official who is in a position to act on the issue in connection with a specific event (e.g., will vote on the legislation), and
- the candidate is identified solely in a list of the legislation's key sponsors.

The ruling provides six examples that involve 501(c)(4), 501(c)(5), and 501(c)(6) organizations making expenditures for issue advocacy communications. The examples explain whether each expenditure is for an "exempt function" and, therefore, taxable under IRC § 527(f). There was little guidance in this area prior to the ruling, but the ruling is consistent with the IRS's position on such things as voter education activities.[4]

If a 501(c) organization makes an expenditure for an "exempt function," then it is taxed at the highest corporate tax rate on the lesser of its net investment income or the amount of taxable expenditures. So long as the organization is allowed to participate in political activity (e.g., is a 501(c)(4), 501(c) (5), or 501(c)(6) organization), its tax-exempt status is not at risk simply because it made a taxable expenditure. In order to avoid being

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[4] *See* PLR 9652026 (1996); PLR 9725036 (1997); PLR 9808037 (1997); PLR 199925051 (1999).

subject to tax, a 501(c) organization may set up a separate segregated fund that qualifies to be treated as a 527 organization.[5]

Section 527 Political Organizations. While the ruling is intended to provide 501(c) organizations with guidance on when they become subject to tax under IRC § 527(f), the ruling also helps clarify the tax treatment of 527 organizations. These organizations are political organizations that are organized and operated primarily to accept contributions and make expenditures for "exempt functions."[6] They are exempt from tax on certain types of income to the extent that the funds are used for "exempt functions." By providing guidance on the definition of "exempt function," the ruling may be helpful to them.

501(c)(3) Organizations. Tax-exempt 501(c)(3) organizations are mainly formed for religious, educational, and charitable purposes. These organizations may lobby on public policy issues, but may not participate in political campaign activity. Although Revenue Ruling 2004-6 does not explicitly address 501(c)(3) organizations, it may still be helpful for determining what 501(c)(3) organizations can and cannot do with respect to issue advocacy communications. This is because the IRS has at times taken the position that political activities prohibited under section 501(c)(3) are correspondingly treated as being for an "exempt function" under section 527.[7] Thus, the ruling may provide guidance on whether the IRS will consider an issue advocacy communication to be a prohibited 501(c)(3) political activity. However, it is not clear that the determination that an activity is for an "exempt function" will necessarily mean that it is a prohibited 501(c)(3) political activity.[8]

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[5] IRC § 527(f)(3).

[6] IRC § 527(e)(1). For further information, see CRS Report RS21716, *Political Organizations Under Section 527 of the Internal Revenue Code*, by Erika Lunder.

[7] For example, see PLR 9652026 (1996); PLR 9725036 (1997); PLR 9808037 (1997); and PLR 199925051 (1999).

[8] *See* Brant Goldwyn, *Nonprofit Groups Can Lobby Office-Holders During Election Campaign, IRS Official Says*, DAILY TAX REPORT (January 29, 2004).