

Civil Society Regulations and Effects

New IRC Section 501(c)(4) Regulations Proposed, On Hold

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On November 29, 2013, the Internal Revenue Service (the “IRS”) issued a Notice of Proposed Rulemaking (“NPRM”)² setting forth new regulations purporting to clarify the boundaries of political activities that may be conducted by “social welfare organizations,” which are exempt from U.S. federal income tax under Section 501(c)(4) of the Internal Revenue Code (the “Code”).³

The NPRM concluded a year that set the high-water mark for public discussion surrounding the relatively little-known tax law concept of “social welfare” in general, and more specifically the questions whether, and if so to what extent, social welfare organizations should be permitted to conduct partisan political activity. Practitioners have been asking these questions for years, because IRS regulations have long provided that (a) a social welfare organization remains qualified for exemption so long as it “primarily” conducts social welfare activities,⁴ and (b) “social welfare” does not include direct or indirect participation or intervention in a political campaign on behalf of or in opposition to any candidate for public office.⁵

These questions gained urgency, however, in 2010 when the United States Supreme Court, in *Citizens United v. FEC*,⁶ struck down a rule under federal election law prohibiting corporations and labor unions from making certain “independent expenditures” (that is, expenditures that are not coordinated with political parties or candidate campaigns) at certain times in connection with federal elections.⁷

Suddenly, social welfare organizations (most of which are corporations) acquired the ability (for federal election law purposes) to make unlimited independent expenditures to

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² 78 Fed. Reg. 71535 (Nov. 29, 2013).

³ Unless otherwise stated, all references herein are to the Code.

⁴ Treas. Reg. Sec. 1.501(c)(4)-1(a)(2)(i). The IRS’s assertion in the regulations of the “primarily” standard is itself controversial because Section 501(c)(4) of the Code requires a social welfare organization to engage “exclusively” in social welfare activities. In other contexts, the IRS has interpreted “exclusively” to mean not “more than an insubstantial part”. See, e.g., Treas. Reg. Sec. 1.501(c)(3)-1(c)(1).

⁵ Treas. Reg. Sec. 1.501(c)(4)-1(a)(2)(ii).

⁶ 558 U.S. 310 (2010).

⁷ 2 U.S.C. 441(b). At issue in the case was the application of the prohibition to communications that referred to a federal candidate within 30 days of the 2008 primary election. The specific communications in question were a documentary film critical of Hillary Clinton, who at the time was a candidate for President, and advertisements promoting the film, which Citizens United, the corporate producer of the film, wanted to distribute via on-demand cable services.

influence federal elections, so long as the organizations remained, for federal tax purposes, “primarily” engaged in social welfare activities.

Perhaps most important, because social welfare organizations are not required by the tax law to publicly disclose their donors, the financiers of these independent expenditures in support of or opposition to federal candidates would remain hidden from public view. For funders concerned about anonymity, this made social welfare organizations more appealing than political organizations exempt from federal tax under Section 527, which solely conduct partisan political activity but must publicly disclose their donors.⁸

Citizens United thus set the stage for the hubbub leading to the NPRM, which arose in May 2013 after a top Exempt Organizations official at the IRS, Lois Lerner, disclosed, during a public question-and-answer session at an American Bar Association meeting, that IRS agents charged with evaluating exemption applications from social welfare groups had flagged for further review applicants whose names contained certain words, such as “Tea Party” and “patriot.”⁹ Swift and intense public outrage ensued, particularly from the political Right, which perceived the focus on such terms, generally associated with conservative interests, as evidence that the Obama Administration was specifically targeting conservative groups. In materials and statements released after the initial firestorm, the IRS revealed that the use of watch-words was actually broader, including left-leaning terms like “progressive” as well.

A crescendo of far-reaching Congressional and independent investigations ensued, some of which continue today. None of these analyses have so far revealed persuasive evidence of political meddling from outside the IRS (including, in particular, the White House), but the scandal and its fallout put the rules governing the political activities of social welfare organizations squarely on the public agenda.

The conversation has continued, with vigor. In response to the NPRM, the IRS received over 160,000 comments, more than ten times the previous record, fueling speculation that the summer might bring exciting (!) IRS hearings on the proposed regulations.¹⁰

However, under the weight of the public commentary, much of which leveled criticisms, complaints, and concerns about the NPRM, the IRS announced on May 22, 2014, that it will not hold hearings until after it issues a revised draft of the regulations.¹¹ In an interview on June 17, 2014, IRS Commissioner John Koskinen indicated that the revised, proposed regulations will be issued early in 2015, and will be broader in scope than the NPRM.¹² Commentators such as the

⁸ 26 U.S.C. 527(j)(3)(B).

⁹ Ms. Lerner has since retired from the IRS and declined to testify before a Congressional hearing (invoking the Fifth Amendment). On May 7, 2014, the House of Representatives voted, along mostly partisan lines, to hold her in contempt of Congress. Prosecution, which would fall to the U. S. Department of Justice, seems unlikely.

¹⁰ For a look at 25 unscientifically-selected but well-crafted comments submitted by organizations ranging from the ACLU to the NRA, visit Adler & Colvin’s blog, www.nonprofitlawmatters.com, and search for “Top 25.”

¹¹ *IRS Update on the Proposed New Regulation on 501(c)(4) Organizations*. Retrieved from <http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501%28c%29%284%29-Organizations> on June 24, 2014.

¹² Patel, J., (June 18, 2014). *IRS chief promises stricter rules for ‘dark money’ nonprofit groups*. Retrieved from <http://www.publicintegrity.org/2014/06/18/14960/irs-chief-promises-stricter-rules-dark-money-nonprofit-groups> on June 24, 2014. Commissioner Koskinen was quoted as saying that the new regulations would address

American Bar Association Section on Taxation, among others, encourage the IRS to consider expanding the reach of the new regulations to encompass political activities by organizations exempt under other subsections of Section 501(c)(3), as well, such as labor unions (exempt under Section 501(c)(5)) and trade associations, chambers of commerce, and business leagues (exempt under Section 501(c)(6)).¹³

Meanwhile, political operatives on both sides of the aisle continue to take advantage of the opportunity created by *Citizens United*, using social welfare organizations to gather anonymous contributions and spending them lavishly to influence elections. We must wait to see whether the IRS will take meaningful steps to restore transparency.

three aspects of political activity by social welfare organizations: “what should be the definition, to whom should it apply, and how much . . . can you do before you jeopardize your exemption?” *Id.*

¹³ Available online, as of September 18, 2014, at <http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/050714comments.pdf>