Controversy Over Political Activities of Welfare Organizations

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In the wake of the U.S. Supreme Court's landmark decision in *Citizens United v. Federal Election Commission* , which permits corporations to spend unlimited funds on the production and distribution of political advertisements for (or against) candidates running for public office, the Internal Revenue Service has seen a dramatic rise in the formation of nonprofit organizations that engage in political activities. However, many of these newly formed nonprofit organizations are not electing to be tax-exempt under Section 527 of the Internal Revenue Code of 1986 as amended — the section specifically intended for political organizations. Instead, in an effort to keep the identity of donors anonymous, many groups are electing tax-exempt status under the social welfare organizations provision of Section 501(c)(4), which lacks the donor disclosure requirements of Section 527.

Allegations have been made that the IRS is subjecting certain political nonprofit organizations, such as various Tea Party groups that have applied for tax-exempt status under the IRC's Section 501(c)(4) to heightened scrutiny due to their political campaign activities, despite the fact that other social welfare organizations have also historically engaged in such activities.

Under the IRC's Section 501(c)(4), nonprofit organizations operating exclusively for the promotion of social welfare are exempt from income taxation if the organization's earnings do not benefit any shareholder or individual and if no substantial part of its activities consists of providing commercial-type insurance. The Treasury regulations expand upon the meaning of "social welfare," stating an organization is considered to be operated exclusively for the promotion of social welfare so long as it is primarily engaged in promoting the common good and general welfare of the people of the community in some way. However, the Treasury regulations specifically exclude participation in political campaigns from being considered the promotion of social welfare.

Yet, social welfare organizations are not prohibited from engaging in political campaign activities. The IRS, in a 1981 Revenue Ruling, held that a social welfare organization may engage in lawful political campaign activities for (or against) certain candidates running for public office so long as such activities do not constitute the organization's "primary" activity. Unfortunately, neither the Treasury regulations nor the Revenue Ruling define what constitutes as "primary" activity.

Social welfare organizations initially caught the media's attention in spring 2011 when it was reported that the IRS was examining several donors for their failure to file and pay

gift tax for their contributions to certain social welfare organizations engaged in political campaign activities. Inquiries were made regarding whether the IRS's examination was politically motivated or simply part of an increased effort to enforce gift tax laws. A gift tax is generally imposed under the IRC's Section 2501(a) when money or other property is gratuitously transferred.

The IRC provides an exclusion from gift tax for gifts made to qualifying political organizations and also a deduction for charitable gifts. However, there is no similar exclusion or deduction for gifts made to social welfare organizations. Thus, money or other property transferred by gift to a social welfare organization should, in theory, be subject to gift tax. Formal guidance is limited in this area because the IRS has historically not enforced this nuanced part of the law. After several media reports on this issue, the IRS, in July 2011, suspended its examinations and stated it no longer planned to enforce gift tax with respect to social welfare organizations, at least until Congress either takes action to require the IRS to charge the tax or until the IRS can spend more time studying the issue and explain its views to the public.

The current controversy surrounding social welfare organizations heated up when certain Tea Party groups publicly complained that their applications for Section 501(c)(4) nonprofit status were being subject to heightened scrutiny by the IRS, resulting in significant delays in the approval process. For example, in January 2012, the IRS requested that the Richmond Tea Party, which applied to become a social welfare organization in December 2009, provide a full list of its donors and volunteers and inquired about whether the organization had engaged in lobbying or had business dealings with candidates for public office. These inquiries raised concerns that the IRS was exceeding its scope of the typical disclosures required under IRS Form 1024.

In response to these complaints, Charles W. Boustany Jr., chair of the Ways and Means Oversight Subcommittee, sent several letters to IRS Commissioner Douglas Shulman requesting information about the status of various IRS compliance efforts involving the tax-exempt sector and the IRS's oversight of the applications for tax exemption specifically related to any Tea Party group. Unsatisfied with the response he received from the IRS, Boustany recently set up a series of congressional hearings to explore the IRS's activities in investigating political groups seeking tax-exempt status.

In addition, 12 Republican senators wrote to Shulman expressing their concern over the IRS's inquiries received by certain organizations applying for tax-exempt status that were perceived to be excessive. The senators urged the IRS to pursue federal tax compliance efforts without regard to politics of any kind and requested assurance that the recent inquiries had a sound basis in law and were consistent with the IRS's treatment of tax-exempt organizations across the spectrum.

In the interim, seven Democratic senators, including Senate Finance Committee member Charles E. Schumer, called on the IRS to investigate whether certain social welfare organizations enjoying tax-exempt status under the IRC's Section 501(c)(4) were improperly engaged in political campaign activities. In a letter to Shulman, the

senators indicated concern that certain social welfare organizations were abusing their special tax status by engaging in substantial or even a predominant amount of campaign activity. In reviewing the IRC's Section 501(c)(4), the related Treasury regulations and certain federal court cases, they concluded that the Treasury regulations issued for the IRC's Section 501(c)(4) were more permissive than the language of the statute as interpreted by the federal courts.

In a subsequent letter, the same Democratic senators urged the IRS to impose a reporting requirement on social welfare organizations with political activities as well as a strict, percentage-based cap on the total amount of money a social welfare organization may spend on political activities. Some have proposed that this cap be set at 49 percent to ensure that political activities never account for more than half of an organization's total spending. However, the senators advocate that this percentage would allow for more political activity than should be permitted under the law.

In light of the recent congressional hearings, it is unclear whether Congress will develop more concrete standards for nonprofit social welfare organizations engaged in political activities. It is more likely that in the aftermath of this controversy, the IRS, through its revision of the Treasury regulations, will provide more guidance as to the definition of "primary" activity. With the high court's decision in *Citizens United* prompting a rise in the formation of "social welfare" organizations, it is imperative that either Congress or the IRS step up and clarify the extent to which a social welfare organization may engage in political activities. If not, every election year will devolve to similar controversy that will only damage the IRS's reputation for consistent enforcement of the law.