Tax Insights & Commentary

Reporting Political, Lobbying Activities of 501(c) Organizations

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A recently released congressional report hints that there soon may be greater scrutiny of political and lobbying activity by 501(c) organizations. As the deadline for filing Forms 990, 990-EZ, and 990-PF approaches, such organizations should take extra care when analyzing and reporting lobbying activity, says Mayer Brown attorney George Haines.

On April 29, the Joint Committee on Taxation published a report titled "Laws and Enforcement Governing the Political Activities of Tax Exempt Activities," summarizing the tax treatment of political activity and lobbying by tax-exempt organizations. In the case of 501(c)(4), 501(c)(5), and 501(c)(6) organizations, the report noted the growth of their participation in political campaign activity and suggested that one explanation is the increased anonymity to donors of these organizations as compared to donors of Section 527 political organizations. The report suggested that 501(c)(4), 501(c)(5), and 501(c)(6) organizations could be used to influence elections in a way that permits "less transparency with respect to the ultimate sources of an organization's financial support."

This perceived lack of transparency has become more salient in recent years. The report noted that in May 2020, the final Treasury Regulations published under Section 6033 of the Internal Revenue Code eliminated the requirement that most organizations, other than 501(c)(3) organizations and Section 527 political organizations, provide the names and addresses of substantial contributors to the IRS on Schedule B of Form 990—although donor names and addresses were already shielded from public inspection. Legislation that would have overruled these regulations in order to require donor disclosure in the case of 501(c)(4), 501(c)(5), and 501(c)(6) organizations has stalled.

The report also pointed to the increased use of 501(c) organizations for political campaign activity in the wake of the U.S. Supreme Court's decision in *Citizens United v. Federal Election Commission*, which loosened federal restrictions on independent expenditures, including by 501(c) organizations. The report went on to describe the current state of prohibitions on political activity imposed on 501(c)(3) and other 501(c) organizations, highlighting the difficulty in determining whether a particular activity is prohibited political activity or permissible "issue advocacy." This section of the report described a 2013 IRS proposal that would have replaced the facts-and-circumstances analysis for 501(c)(4) organizations with a list of specific political activities that would not be permitted for 501(c)(4) organizations. That proposal was withdrawn after receiving over 150,000 comments.

Another difficulty noted by the report was the issue of attribution of political activity to a 501(c)(3) organization, such as in the case of political activity by an individual affiliated with a charity. In that situation, the IRS would need to examine all facts and circumstances to determine whether the individual was acting in their private capacity or whether the activity should be imputed to the 501(c)(3) organization. Similarly, in the case of a 501(c)(3) organization affiliated with a 501(c)(4) organization, the IRS would need to delve into the facts of the relationship between the organizations. The organizations' independence would generally be respected even if there were overlapping governing boards provided the entities were separately incorporated, their records and finances showed legally distinct entities, and any reimbursements for shared facilities or services met fair market value standards.

The report also described the lobbying rules and penalties applicable to 501(c)(3) organizations, including the substantial part test—i.e. ensuring that no substantial part of the organizations activities constitute lobbying—and the expenditure test, i.e., making an election under Section 501(h) of the Internal Revenue Code to allow lobbying expenditures up to a sliding-scale formula based on the organization's exempt purpose expenditures.

In describing the rules on reporting lobbying activities, the report noted the requirement to disclose such activities on Schedule C of Form 990. In addition to the required reporting to the IRS, the report noted that a 501(c)(4), 501(c)(5), or 501(c)(6) organization that receives membership dues is generally required to provide flow-through information disclosure to their members estimating the portion of the members' dues allocable to political campaign activities or lobbying activities.

The final section of the report provided data on the number of 501(c)(3) organizations reporting lobbying expenditures and the aggregate dollar amounts reported, with 9,518 Forms 990 and 990-EZ reflecting a total of $691,223,737 in lobbying expenditures in 2018. This data also showed the number of 501(c)(3) organizations recognized as of 2020—1,404,170—and the number of IRS return examinations closed for Forms 990, 990-EZ and 990-N—1,417 for fiscal year 2020 and 2,004 for fiscal year 2018.

This report was released in advance of a May 4 public hearing before the Subcommittee on Taxation and IRS Oversight of the Senate Finance Committee. While the exact focus of the hearing is not entirely clear, several of the invited witnesses have indicated that they intend to testify about perceived abuses and lack of transparency in political and lobbying activity by 501(c)(4) and 501(c)(3) organizations.

Implications for 501(c) Organizations

While it is unclear what changes the Subcommittee on Taxation and IRS Oversight has in mind, the emphasis on transparency and donor disclosure suggests that one goal will be pushing for donor disclosure for organizations engaging in lobbying or political activity.

The report also analyzed the rules and penalties regarding political activity and lobbying in close detail, suggesting that tighter restrictions on these activities may be discussed. The report noted a large number of facts and circumstances tests and one failed attempt by the IRS to replace a facts and circumstances test with an objective test. So another possibility is that the subcommittee will discuss bright line tests that could provide clarity to 501(c) organizations and help the IRS perform audits more efficiently.

The inclusion of 990 reporting and audit data in the report suggests that the subcommittee may press the IRS to increase its auditing rate of organizations engaged in political and lobbying activity. In light of this pressure, 501(c)(3) organizations would be well-advised to carefully monitor their systems for tracking and evaluating lobbying activity. In particular, 501(c)(3) organizations with close ties to 501(c)(4) organizations engaging in political activity or with leaders who engage in political activity in their personal capacities should monitor those relationships to ensure that these activities are not imputed back to the 501(c)(3).

Author Information

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Joint Committee on Taxation report

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