

S. AFFILIATIONS AMONG POLITICAL, LOBBYING AND EDUCATIONAL ORGANIZATIONS

by
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1. Introduction

Issues of concern to people may arise in many contexts. They may wish to educate the public about the issue, to influence legislation concerning the issue, or to influence election campaigns based on candidates' views on the issue. To do so, they form different types of exempt organizations to carry on these different activities. In an increasingly common arrangement, an IRC 501(c)(3) educational organization formally or informally affiliates with an IRC 501(c) (4), (5), or (6) lobbying organization with a related IRC 527 political organization or PAC. For instance, in a House ethics investigation of then-Speaker Newt Gingrich, Mr. Gingrich's counsel submitted an exhibit showing 26 such groups, including such well-known organizations as the National Organization of Women and the Sierra Club, where the organizations in each group shared a common address. See "Report of Counsel for Respondent," Jan. 16, 1997, reprinted in 97 TNT 16-78. Such an affiliated group of organizations is typically committed to a certain idea or movement, such as civil rights, family values, or environmental preservation.

Are such affiliations of IRC 501(c)(3) organizations with non-IRC 501(c)(3) organizations permissible under IRC 501(c)(3)? Are any arrangements impermissible under Subchapter F? Does the form of the affiliation matter? Are there any potential problems to watch out for on audit? This article will address these issues, with a focus on the exemption of the IRC 501(c)(3) organization affiliated with other organizations engaged in political intervention and substantial lobbying. These issues were also discussed in some detail in 1993 CPE 400 and 1997 CPE 261--the reader is also directed to those articles for the discussion therein, and for a fuller treatment of political intervention and lobbying issues affecting exempt organizations generally.

2. Formation and Control of IRC 501(c)(3) Organizations by Non-IRC 501(c)(3) Persons

A. Control by IRC 501(c) Organization

The longstanding Service position is that an IRC 501(c)(3) organization may under proper circumstances be formed and controlled by an organization exempt under another subsection of IRC 501(c). For instance, Rev. Rul. 54-243, 1954-1 C.B. 92, cited in Rev. Rul. 77-232, 1977-2 C.B. 71, and Rev. Rul. 58-293, 1958-1 C.B. 146, held that an IRC 501(c) organization may set up a separate IRC 501(c)(3) fund. IRC 509(a)(3) specifically contemplates, in a notably obscure fashion, that a 509(a)(3) supporting organization may be controlled by a publicly supported IRC 501(c)(4), IRC 501(c)(5), or IRC 501(c)(6) organization. Rev. Rul. 77-272, 1977-2 C.B. 191, held exempt under

IRC 501(c)(3) an organization operated by labor union representatives and formed to operate a program created by the union. Also, Example (7) of Reg. 56.4911-7(f) sets forth as an example of an affiliated group for purposes of IRC 4911(f) an IRC 501(c)(4) organization controlling two IRC 501(c)(3) organizations.

B. Control by Individuals Associated With Non-IRC 501(c) Organization

Similarly, an IRC 501(c)(3) organization may be formed and controlled by one or more individuals affiliated with a particular taxable or other non-IRC 501(c) organization. Rev. Rul. 66-219, 1966-2 C.B. 208, held that an IRC 501(c)(3) organization may be formed and controlled by a single individual or trustee. In Rev. Rul. 66-358, 1966-2 C.B. 218, an organization held exempt under IRC 501(c)(3) had a board consisting solely of officers of a particular taxable corporation. Many taxable corporations establish private foundations controlled by officers of the corporations through which they conduct charitable activities.

However, the activities of the related foundation must not be for the benefit of the corporation. For example, Rev. Proc. 76-47, 1976-2 C.B. 670, and Rev. Proc. 80-39, 1980-2 C.B. 772, require that a private foundation's selection committee for any employer-related scholarship and loan program be comprised of individuals unrelated to the employer. If not, the activity is not charitable.

Bob Jones Univ. Museum & Gallery, Inc. v. Commissioner, TCM 1996-247, held exempt under IRC 501(c)(3) a separately incorporated museum on the campus of Bob Jones University (a non-exempt university), finding any benefit to the University incidental. The museum had a self-perpetuating board of five directors that included two University officials (Bob Jones Jr. and Bob Jones III), and three of its four officers were also high University officials. In discussing whether the presence of University officials on the museum's board would unduly benefit the University, the court noted that overlapping boards are not necessarily impermissible (citing Rev. Rul. 66-358), that University employees did not control the board, and that control would be relevant only if the museum made unreasonable payments to the University.

So, the issue is not whether another entity controls the IRC 501(c)(3) organization, but whether the controlling entity uses its control for its own benefit. For instance, courts have found a substantial non-exempt purpose to benefit a for-profit entity where its principals control or influence an IRC 501(c)(3) organization that is used to generate business for the for-profit entity. See, e.g., est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), affirmed by unpublished opinion, 647 F.2d 170 (9th Cir. 1981); P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984); Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985); International Postgraduate Medical Foundation v. Commissioner, T.C.M. 1989-36; KJ's Fund Raisers, Inc. v. Commissioner, 98-2 U.S.T.C. 50,869 (2d Cir. 1998). Similarly, there are ways in which an IRC 501(c)(3) organization may improperly benefit an affiliated IRC 501(c)(4) or IRC 527 organization, resulting in a

political intervention by the IRC 501(c)(3) organization or a substantial non-exempt purpose to benefit the non-IRC 501(c)(3) organization.

American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), held not exempt under IRC 501(c)(3) an organization organized primarily to conduct a school for political campaign professionals. The court found a substantial purpose to benefit Republican organizations and candidates. One of the factors that influenced the court's decision was that one of the three initial directors was Executive Director of the National Republican Congressional Committee (NRCC), and another was a member of the Republican National Committee. However, there were also other adverse factors. The organization grew out of the NRCC's training program, and was funded exclusively by the National Republican Congressional Trust. Course materials had a partisan bias, with discussions such as "How Some Republicans Have Won Black Votes" and "Use of GOP Allies". Student applicants' political affiliations were apparent from their applications. In addition, the organization helped place graduates in campaigns, all (or nearly all) of which were for Republican candidates. So, American Campaign Academy does not hold that mere control of an organization by operatives of a particular political party is sufficient to show a substantial non-exempt purpose to benefit private interests.

3. Formation and Control by IRC 501(c)(3) Organization of Non-IRC 501(c)(3) Organizations

A. Formation and Control of Other Organizations

Generally, the Service will respect the separate corporate existence of corporations formed by IRC 501(c)(3) organizations. Several GCMs (most recently, G.C.M. 39776 (Aug. 25, 1988)) state that an IRC 501(c)(3) organization can establish a subsidiary to conduct activities that the IRC 501(c)(3) organization could not, unless the subsidiary is a mere arm, agent, instrumentality, or integral part of the IRC 501(c)(3) parent. These GCMs are based fundamentally on Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943), which held that, for income tax purposes, a taxpayer cannot ignore the form of the corporation that he creates for a valid business purpose or that subsequently carries on business, unless the corporation is a sham or acts as a mere agent. In Moline, the taxpayer argued that his wholly owned corporation should be disregarded, but courts generally apply the principle that a corporation should be treated as a separate entity whether the taxpayer or the Service seeks to pierce the corporate veil. With exempt organizations, this principle tends to favor the taxpayer.

One exception to the Moline doctrine is for sham organizations. An organization is not considered a sham for tax purposes unless it is organized solely to avoid taxes rather than for a substantial business purpose, and it conducts no substantial business. See, e.g., Gregory v. Helvering, 293 U.S. 465 (1935); Higgins v. Smith, 308 U.S. 473 (1940). What

is a valid business purpose for an exempt organization? Exempt organizations often do not conduct "business" in the usual sense of the term. In the context of exempt organizations, "business" is construed as activity permitted under the particular Code section. See G.C.M. 39598 (Dec. 8, 1986). So, an IRC 501(c)(4) organization created to solicit contributions and lobby to further pro-life or pro-choice causes can promote social welfare and so have a valid business purpose.

Moline also provides that a corporation's activities are attributable to another where it is acting merely as the other's agent. When will this be the case? Because of the potential for after-the-fact tax avoidance or gamesmanship, the Supreme Court set out narrow circumstances in which a taxable corporation may be regarded as an agent for tax purposes. In essence, the organization's agency must be unambiguous. National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949), set forth several considerations and requirements:

Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money it receives to the principal, and whether income is attributable principal's employees or assets are relevant considerations for determining if true agency exists. If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purpose must be carrying on of the normal duties of an agent.

Commissioner v. Bollinger, 485 U.S. 340 (1988), held that a corporation acted as its shareholders' agent for a particular asset because the agency agreement was written contemporaneously, the corporation acted solely as an agent, and the corporation held itself out as agent in all dealings with third parties.

Center on Corporate Responsibility, Inc. v. Schultz, 368 F.Supp. 863 (D.D.C. 1973), held exempt under IRC 501(c)(3) an organization with a taxable "sister" organization, with a similar name and goals, that engaged in certain activities (for example, acting as a plaintiff in proxy contests, which the Service regarded as improper for the IRC 501(c)(3) organization to conduct) that the IRC 501(c)(3) organization could not conduct. The IRC 501(c)(3) organization sought, through education and litigation, to promote social welfare considerations in corporate decisions. The four members of the taxable organization's board also served on the IRC 501(c)(3) organization's 16-member board. The taxable organization was separately incorporated and maintained separate bank accounts, but shared office space and some personnel with the IRC 501(c)(3) organization, evidently with the arrangement that it would reimburse the IRC 501(c)(3) organization for an allocable share of expenses. The court noted that the Service had previously permitted interlocking directorates and overlapping personnel between IRC 501(c)(3) and non-IRC 501(c)(3) organizations (for example, the identity of directors and officers between the ACLU and its recognized IRC 501(c)(3) affiliate). Further, the organizations

were separate, had separate bank accounts, and held themselves out as separate entities; and found any support of the taxable organization by the IRC 501(c)(3) organization (even if it did not further exempt purposes) to be insubstantial.

B. Formation and Control of IRC 501(c)(4) Organization

An IRC 501(c)(3) organization can establish and control an IRC 501(c)(4) organization to conduct lobbying. Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983), held that the IRC 501(c)(3) prohibition of substantial lobbying was constitutional, concluding that an organization's right to speak need not be subsidized. The Supreme Court noted that the organization could have used a dual structure (as it had in the past), with an IRC 501(c)(4) organization for lobbying and an IRC 501(c)(3) organization for other activities; that there is apparently no prohibition against an IRC 501(c)(3) establishing an IRC 501(c)(4) lobbying affiliate; and that the Service apparently requires only that the two groups be separately incorporated and keep records adequate to show that tax-deductible contributions are not used to pay for lobbying. The Supreme Court emphasized the importance of the IRC 501(c)(4) alternative to its Taxation With Representation holding in a subsequent opinion, FCC v. League of Women Voters of California, 468 U.S. 364, 399-401 (1984).

Consistent with the principles of Moline, the Service will recognize the IRC 501(c)(4) subsidiary and its activities as separate from the IRC 501(c)(3) parent under the following circumstances:

1. The IRC 501(c)(4) subsidiary must be separately organized.
2. The IRC 501(c)(4) subsidiary must keep records and bank accounts separate from those of the IRC 501(c)(3) parent.
3. If there are overlapping paid officers, directors, or employees, their time must be allocated between the organizations based on the activities they work on for the respective organizations.
4. The organizations must reasonably allocate other shared goods, services, and facilities.

In essence, an organization affiliated with an IRC 501(c)(3) organization must observe the formalities of its separate organizational status and deal with the IRC 501(c)(3) organization at arm's length. Otherwise, its activities may be considered activities of the IRC 501(c)(3) organization, especially if the IRC 501(c)(3) organization provides any subsidy.

Also, under proper circumstances, an IRC 501(c)(3) organization may distribute an educational document to further an educational purpose without being considered to have lobbied even if the same document is simultaneously or later distributed in a lobbying communication by the same organization or by an IRC 501(c)(4) organization. See Reg. 56.4911-2(b)(2)(v).

C. Formation and Control of IRC 527 Organization

An IRC 501(c)(3) organization cannot establish an IRC 527 organization to conduct political intervention activities that it could not directly conduct. See S. Rep. No. 93-1374, 93d Cong., 2d Sess. 30 (1974), 1975-1 C.B. 517, 534 and Reg. 1.527-6(g). Under IRC 527, an IRC 501(c) organization that establishes a separate segregated fund may incur certain expenditures without being subject to tax because regulations concerning expenditures allowed under Federal Election Commission (FEC) rules and indirect expenditures were reserved. Reg. 1.527-6(b)(2) and Reg. 1.527-6(b)(3). The Supplementary Information to the final regulations, T.D. 7744, 1981-1 C.B. 360, explains that when these two subparagraphs are adopted as a final regulation, they will apply prospectively. To date, these regulations have not been promulgated. Thus, an IRC 501(c) organization can treat these expenditures as not taxable under IRC 527(f). As noted, under FEC rules, a corporation that establishes a connected political action committee (PAC) may incur certain expenditures without it being considered a contribution. See 11 C.F.R. § 114.1(a)(2)(iii) and 11 C.F.R. § 114.5. These activities would nonetheless constitute an intervention by the IRC 501(c)(3) organization. Thus, an IRC 501(c)(3) organization may not establish a connected federal PAC that would support or oppose candidates for public office.

In limited situations, an IRC 501(c)(3) organization could, however, establish an IRC 527 organization solely to conduct exempt functions under IRC 527 that would qualify as lobbying under IRC 501(c)(3) (i.e., attempting to influence the selection of a federal judge). See Notice 88-76, 1988-2 C.B. 392; Announcement 88-114, 1988-37 I.R.B. 26.

4. Formation and Control by IRC 501(c) Organization of IRC 527 Organization

While IRC 501(c)(3) and other IRC 501(c) organizations may not participate in political activities, other IRC 501(c) organizations are not similarly prohibited. So, an IRC 501(c)(4), IRC 501(c)(5), or IRC 501(c)(6) organization may conduct political intervention activities and may establish and control a separate segregated fund to conduct exempt functions under IRC 527, so long as political intervention is not its primary activity.

Political intervention does not promote social welfare (Reg. 1.501(c)(4)-1(a)(2)(ii)). However, an IRC 501(c)(4) organization may intervene in political campaigns if it primarily engages in activities that promote social welfare. Rev. Rul. 81-95, 1981-1 C.B. 332. Similar rules apply to IRC 501(c)(5) and IRC 501(c)(6) organizations. However, so

the IRC 501(c) organization is treated similar to an IRC 527 organization, its political expenditures are taxable under IRC 527(f) to the extent of its investment income. Thus, the Code and regulations encourage an IRC 501(c) organization to establish a separate segregated fund if it contemplates political campaign intervention, to avoid the tax imposed by IRC 527(f) on direct expenditures by the IRC 501(c) organization.

5. IRC 501(c)(3) Officials Acting in Individual Capacity

The fact that an IRC 501(c)(3) organization cannot establish an IRC 527 organization does not mean that the officials of the IRC 501(c)(3) organization cannot, in their capacity as individuals, establish an IRC 527 organization. Those individuals have First Amendment rights to form associations with others and to engage in politics, even if they are also involved with an IRC 501(c)(3) organization. The individuals may form a non-connected political action committee under FEC rules. See Advisory Opinion 1984-12 (May 31, 1984).

Where do we draw the line between an IRC 501(c)(3) organization "establishing" an IRC 527 organization, on the one hand, and IRC 501(c)(3) officials acting in their individual capacity establishing an IRC 527 organization, on the other? What does it mean for one organization to "establish" another? Basically, there are three requirements.

First, an IRC 501(c)(3) organization cannot formally control an IRC 527 organization. For instance, it cannot have the right to appoint (or approve) the board of the IRC 527 organization. The governing documents of the IRC 501(c)(3) or IRC 527 organization cannot say that the IRC 501(c)(3) board members constitute the IRC 527 board members. There should be no such formal affiliation.

Second, none of the IRC 501(c)(3) organization's assets can be used to set up or operate the IRC 527 organization. There are many ways in which IRC 501(c)(3) assets can be used to support an IRC 527 organization, which must be avoided. An organization's assets include its funds and investment assets, facilities and equipment, personnel, mailing lists, and its name or goodwill. If personnel, facilities, or equipment are shared, then there must be reasonable allocations of expenses based on arm's-length standards, and records kept to substantiate the allocations, including the time spent by shared employees working for each organization.

Unlike other assets of the IRC 501(c)(3) organization, its mailing list may be unique and so particularly valuable to one or more political organizations or candidates. Thus, the IRC 501(c)(3) organization may not sell or rent its mailing list to the IRC 527 organization without making it available to all other political organizations and candidates on an equal basis. Any dealings also must be on arm's-length terms.

Since the IRC 527 organization is created by individuals and not by the IRC 501(c)(3) organization it should not use the name of the IRC 501(c)(3) organization as part of its name. This is distinguishable from the situation in which the IRC 501(c)(3) organization is affiliated with an IRC 501(c) organization with a similar name that has a related IRC 527 organization. The IRC 527 organization is required to include the name of the connected organization (the IRC 501(c)(4) organization) in its name. See 11 C.F.R. § 102.14(c). In that instance, it is the name of the IRC 501(c)(4) organization that is being used, and not that of the IRC 501(c)(3) organization, despite the similarity in names.

Third, any IRC 501(c)(3) officials assisting the IRC 527 organization must truly be acting only in their individual capacity, which is a factual issue. Agency principles determine whether the IRC 501(c)(3) organization has authorized or ratified the acts of those individuals as official acts of the IRC 501(c)(3) organization. For instance, the following statements and other acts would ordinarily be attributable to the IRC 501(c)(3) organization, absent other facts:

- Transaction of business of the IRC 527 organization on stationery bearing the letterhead of the IRC 501(c)(3) organization or signed by IRC 501(c)(3) officials in such capacity (e.g., "John Doe, President of IRC 501(c)(3) organization").
- Acts explicitly authorized by the IRC 501(c)(3) organization's board of directors.
- Statements published by the IRC 501(c)(3) organization in its official publications (including Internet sites) or in mass media advertisements or programs acknowledged as produced by the organization, except where the statement is clearly attributed to someone other than persons who normally speak for the organization.
- Statements made by officials at official events of the IRC 501(c)(3) organization.

Even if the IRC 501(c)(3) organization did not establish the IRC 527 organization, it might indirectly intervene in a campaign or operate for a substantial nonexempt purpose if it improperly coordinates or colludes with the IRC 527 entity. For example:

- Joint fundraising mailings or events.
- Coordinating the content, timing, or distribution of information materials;
- Distribution by the IRC 501(c)(3) organization of materials prepared by the IRC 527 organization, or vice versa. Reg. 56.4911-2(b)(2)(v) may provide general guidance in this regard.

Similar concerns underlie FEC regulations that determine whether expenditures by a PAC are independent of a candidate's campaign or are a contribution in kind to the candidate. See 11 C.F.R. § 109.1. While coordination may often be difficult to prove, any public statements or private memoranda (particularly those of the IRC 501(c)(3) organization) indicating coordination between the officials or agents of the two organizations would be damaging. The mere presence of common officials in both organizations would not prove coordination. In some cases, however, an activity (for example, publishing a position paper or press release several weeks before an election that is a thinly-veiled endorsement or attack of a candidate) may be political intervention even without evidence of coordination with an IRC 527 organization or candidate.

6. Trios of Organizations

So far, we have considered several combinations of two organizations:

- An IRC 501(c) organization establishing an IRC 501(c)(3) organization, which is permissible;
- An IRC 501(c)(3) organization establishing an IRC 501(c)(4) organization to conduct lobbying, which is permissible;
- An IRC 501(c)(3) organization establishing an IRC 527 organization, which is not permissible;
- An IRC 501(c) organization establishing an IRC 527 organization, which is permissible; and
- An IRC 501(c)(3) organization whose officials, as permitted, establish an IRC 527 organization in their capacity as individuals.

Now we will consider triad arrangements. As discussed above, these arrangements involve an IRC 501(c)(3) organization that usually conducts educational advocacy, another IRC 501(c) organization (usually IRC 501(c)(4)) that conducts lobbying, and an IRC 527 organization that conducts political intervention.

One arrangement is to have no organization controlling another, but informal affiliations among the three organizations with common directors. This situation is generally permissible. The considerations discussed above regarding establishment of the IRC 527 organization by the IRC 501(c)(3) organization would apply here as well to the relationship between the IRC 527 and IRC 501(c)(3) organizations.

Another permissible structure is for an IRC 501(c) parent to have both an IRC 501(c)(3) subsidiary and an IRC 527 separate segregated fund. Again, while the IRC 501(c)(3) organization may share officials with the IRC 527 organization, it may not establish the IRC 527 organization. The facts and circumstances would need to indicate establishment by the IRC 501(c) parent.

A third combination is for an IRC 501(c)(3) parent to have an IRC 501(c)(4) subsidiary which itself has an IRC 527 separate segregated fund. Because the IRC 501(c)(4) subsidiary is separate, it would have the same rights as other IRC 501(c)(4) organizations to intervene in political campaigns or establish separate segregated funds. Unless the IRC 501(c)(4) organization uses resources or assets of the IRC 501(c)(3) parent in those activities, its activities would not be imputed to the IRC 501(c)(3) parent.. The IRC 501(c)(4) organization could not use any funds it receives from the IRC 501(c)(3) organization to support political campaign activities. The IRC 501(c)(3) organization should exercise control sufficient to ensure that any funds it granted to the IRC 501(c)(4) organization are used for educational or other charitable activities, or for lobbying activities (provided the lobbying activity of the IRC 501(c)(3) organization including these grants are not a substantial activity of the IRC 501(c)(3) organization). The considerations that prevent an IRC 501(c)(3) organization from establishing a IRC 527 organization also apply to the relationship between the IRC 501(c)(3) organization the political campaign intervention of the IRC 501(c)(4) organization, or the IRC 527 organization set up by the section 501(c)(4) organization.

An important asset of an IRC 501(c)(3) organization is the time of its officers and directors. Thus, minutes of board meetings, and memoranda written by the officers and directors in their capacity as officials of the IRC 501(c)(3) organization, should not evidence direction of the political campaign activities of the IRC 501(c)(4) or IRC 527 organization. Without tangible evidence, or (in the rare case) reliable insider testimony, it is difficult to prove that the IRC 501(c)(3) directed and controlled the political intervention activities of the IRC 501(c)(4) or IRC 527 organizations. The structure alone will rarely establish the control or direction.

7. Conclusion

In summary, some important matters to consider in examining relationships between IRC 501(c)(3), IRC 501(c), and IRC 527 organizations include the following:

1. The organizations must be separately organized, including having separate employer identification numbers. However, the organizational test for IRC 527 organizations is very informal.
2. The organizations should maintain separate records and finances.

3. The IRC 501(c)(3) organization should not subsidize any political intervention activity or substantial lobbying activity of the affiliated organizations in any manner. A subsidy can take several forms:
 - a. Direct transfer of funds to the other organization.
 - b. Paying expenses of the other organization.
 - c. Non-arm's-length dealing for shared facilities or employees.
 - d. Use of the IRC 501(c)(3) mailing list on a preferential or non-arm's length basis.
4. The IRC 501(c)(3) officials should not direct or assist in the political intervention activities of other organizations in their capacity as IRC 501(c)(3) officials.
5. The IRC 501(c)(3) organization should not coordinate its activities with a non-IRC 501(c)(3) organization for partisan political purposes, including any coordination with a candidate or IRC 527 organization.

In summary, organizations, despite affiliations, must observe the formalities of their status as organizations separate from the IRC 501(c)(3) organization, the IRC 501(c)(3) organization must deal with them on an arm's length basis, and the organizations must confine their activities to those permitted by their respective exempt Code sections.