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POLITICAL ACTIVITY BY NONPROFIT ORGANIZATIONS

INTRODUCTION

This Article is intended to outline a brief history of the permissible political activities of nonprofit corporations, and identify the dramatic changes which occurred in January 2010 with the United States Supreme Court decision in the case of Citizens United v. Federal Election Commission.¹ In order to understand the magnitude of these changes, a brief history of nonprofits might be in order.

HISTORY

For nearly two hundred years our Congress has supported the charitable nature of most nonprofit organizations. In a sense, by designating them as tax free, the government tacitly underwrote Colleges, Universities, charities, churches, chambers of commerce and other organizations that were set up to benefit particular areas of our society. In return, the government historically insisted that these independent, tax free organizations use their funds for the specific purposes of the 501(c) undertaking and not redirect those donated funds into the political arena. Great care was taken, in each state, to structure how the nonprofits were to be set up, and qualify for tax exemption. We note below, for example, the detail for Illinois which is similar to the incorporation path of all the other states. Understanding the micro-focus of the incorporation process and then the application for tax exemption process so as to insure the separation of donated funds from political campaigns will, we hope, give you a sense of the magnitude of the changes wrought by the Citizens United case, as well as the numerous unanswered questions that continue to plague the nonprofit sector.

Many nonprofit organizations are state-based corporations. For example, in Illinois, the General Not-For-Profit Corporation Act of 1986² authorizes 33 “purposes” for incorporation,

¹ 130 S. Ct. 876 (2010).

² 805 ILCS 105 *et seq.*

including charitable, educational, civic, political, religious, etc.³ The essential difference between a nonprofit corporation, and one that is for-profit, has been described by Professor Henry B. Hansmann as:

A nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it....⁴

The gist of this definition clearly distinguishes the for-profit from the not-for-profit forms. A for-profit corporation exists for the financial benefit of its shareholders (or members of an LLC, for example). The shareholders can receive their “profit” in the form of dividends, or sell their shares, or participate in any liquidation.

On the other hand, there simply are no “shareholders” of a nonprofit (though there may be non-owner members); i.e., there are no dividends, and any liquidation of the company’s assets must inure to the benefit of another like-qualifying nonprofit rather than those who control it.⁵ In short, all of the assets of the nonprofit must be used for the stated purpose of the incorporation (education, religious, etc.), even in dissolution.

In Illinois, incorporating as a nonprofit is as simple as going online to the Illinois Secretary of State’s website and completing Form NFP-102.10, the Articles of Incorporation for nonprofits.⁶ The fee is \$77.75.⁷

Once incorporated in Illinois, the incorporators will usually apply to the IRS for tax-exempt status, using IRS Form 1023.⁸ Considerable thought needs to be given on the Illinois form (NFP-102.10) at Article 5, which requires a complete and separate statement by which the Illinois nonprofit will meet the IRS requirements for tax exemption. Upon receipt of the completed form, and payment of the user fee,⁹ the IRS will review the application, and if appropriate, issue its favorable determination letter under one of the applicable 501(c) categories. Churches, by the way, do not even need to apply for exemption...it’s automatic.¹⁰

³ 805 ILCS 105/103.05(a).

⁴ *The Role of Nonprofit Enterprise*, 89 Yale L.J. 835 (1980).

⁵ 805 ILCS 105/112.16.

⁶ www.cyberdriveillinois.com, “Business Services,” “Not For Profit Articles of Incorporation” (Form NFP-102.10).

⁷ See fn. 6. \$50.00 (filing fee) + \$25.00 (expedited fee) + \$2.75 (payment processing fee).

⁸ Available at www.irs.gov.

⁹ See Part XI of Form 1023 to determine the user fee.

¹⁰ See page 1 of Instructions for Form 1023, “Overview of Section 501(c)(3) Organizations.”

Individual contributions to 501(c)(3) organizations are deductible as charitable contributions on the donor's federal income tax return.¹¹

While there are many more technical aspects to the filing and reporting requirements, the most significant is probably the informational return, Form 990, which is required to be filed each year by the qualifying, exempt organization.¹²

TAX EXEMPTION

Nonprofit corporations that have been qualified by the IRS as exempt do not pay income taxes, nor do they pay property taxes, for example.¹³ In addition to the commonly known 501(c)(3) category for colleges, universities, hospitals, and churches, there are many other categories of 501(c) nonprofits. Among those are chambers of commerce¹⁴ and political organizations...most often known as "PACs".¹⁵ All are tax-exempt.

NONPROFIT POLITICAL ACTIVITY

Once incorporated as a nonprofit, and exempt from income taxation, many organization board of directors will be interested in using some of the corporate assets to engage in political activity (influencing legislation, supporting/opposing candidates, etc.). There are at least 28 different categories of 501(c) organizations recognized by the IRS,¹⁶ which, along with the Federal Election Commission, regulate the political activity of the nonprofit.

501(c)(3) charitable, religious, or educational nonprofits simply do not qualify for tax-exempt status if a substantial part of their activities is attempting to influence legislation.¹⁷ However, by filling out and filing Form 5768,¹⁸ which is actually a part of the Form 1023 application (!), an otherwise qualifying nonprofit may spend some of its resources to influence legislation. There are set limits on the amount, as described in IRS Publication 557.¹⁹ This

¹¹ See page 6 of Instructions for Form 1023, "Organizations Created in United States Territories and Possessions"; see also the Internal Revenue Code of 1986 ("I.R.C.") § 170.

¹² Form 990 is available at www.irs.gov.

¹³ See generally IRS Publication 557, available at www.irs.gov.

¹⁴ I.R.C. § 501(c)(6).

¹⁵ See I.R.C. § 527.

¹⁶ I.R.C. § 501(c).

¹⁷ See page 2 of Instructions for Form 1023, "Qualification of a Section 501(c)(3) Organization"; see also I.R.C. § 501(h).

¹⁸ Available at www.irs.gov. Form 5768 ("Election/Revocation of Election by an Eligible Section 501(c)(3) Organization To Make Expenditures To Influence Legislation"); see also I.R.C. § 501(h).

¹⁹ *Id.* at pp. 44-45 (Chapter 3, "Lobbying Expenditures").

ability of nonprofits to influence legislation differs completely from the outright ban on their intervention in political campaigns for/against candidates.

All 501(c)(3) organizations are absolutely prohibited from directly or indirectly participating or intervening in any political campaign for or against a candidate for elective public office.²⁰ A simple rule of thumb for directors has historically been that the organization could support issues, but not candidates.

SECTION 527 POLITICAL ACTION COMMITTEES

Section 527 political action committees (“PACs”) are unique tax-exempt nonprofits. They do not provide community benefit, nor mutual benefit...they exist entirely to support, advance, or oppose the political careers of candidates/politicians. This statutory vehicle prevents 501(c)(3) organizations from being taxed²¹ out of existence by the IRS for any violation of the political activity prohibition. PACs, therefore, provide a certain “safe harbor” for the use of tax-exempt funds by nonprofit corporations which support/oppose candidates.

What happens, then, when a nonprofit corporation does not use a PAC to support/oppose candidates, but chooses instead to simply use its own treasury funds? That matter was taken up recently in the case of Citizens United v. Federal Election Commission, 130 S. Ct. 876 (Jan. 21, 2010).

CITIZENS UNITED CASE

The Citizens United case was a landmark decision by the United States Supreme Court that altered more than 200 years of custom and law.

Citizens United, while not a 501(c)(3) organization, was a tax-exempt nonprofit corporation which, according to its website,²² “is an organization dedicated to restoring our government to citizens’ control.” Its PAC, the American Sovereignty Project, “is the grassroots lobbying arm of Citizens United that works to protect American sovereignty and security.” The parent organization, Citizens United, has an annual budget of about \$12 million.²³

In January 2008, Citizens United released a movie that was highly critical of Hillary Clinton, then a candidate for President. The release of the film occurred within 30 days of the primary election, putting it in violation of Section 441b of the Federal Election Campaign Act of 1971.²⁴ The case was initiated (oddly) by Citizens United (not its PAC), which sought an

²⁰ See page 9 of Instructions for Form 1023, “Part VIII – Your Specific Activities,” Line 1.

²¹ I.R.C. § 527(f).

²² www.citizensunited.org.

²³ Citizens United, 130 S. Ct at 887.

²⁴ 2 U.S.C. § 441b, as amended by § 203 of the Bipartisan Campaign Reform Act of 2002. A violation of § 441b subjects the corporation to civil and criminal penalties under § 437g.

injunction against the Federal Election Commission (“FEC”) by asking the District Court for the District of Columbia to prevent the FEC from enforcing Section 441b. The District Court, on cross-motions for summary judgment (there was neither trial nor hearing) ruled in favor of the FEC, effectively giving the FEC free rein to enforce the criminal laws against Citizens United.

On appeal to the United States Supreme Court, Justice Kennedy (along with a majority but highly opinionated and divided court) reversed the lower court, holding that FEC enforcement of the law would violate the corporation’s first amendment rights. Noting that the First Amendment of the Constitution says, “Congress shall make no law...abridging the freedom of speech...”²⁵ Justice Kennedy found that the law (Section 441b) was a ban on speech by the parent nonprofit corporation, notwithstanding the fact that there was an alternative method available to Citizens United (i.e., its PAC).

For the purposes of this Article, and of great concern to the four dissenting justices, is the holding that, “The government may not suppress political speech based on the speaker’s corporate identity. No sufficient governmental interest justifies limits on the political speech of nonprofit or for-profit corporations.”²⁶ In short, Citizens United nearly erases the distinction between for-profit and nonprofit corporations as it relates to political activity. What we are left with are a great number of unanswered questions, among which are:

1. If there’s no distinction here between for-profit and nonprofits, can 501(c)(3) charitable, educational, etc., organizations directly support/oppose candidates in elections? In the recent blog by the Alliance for Justice (www.allianceforjustice.org) that organization commented that the court’s ruling in Citizens United not impact the 501(c)(3) restrictions. True, so far....
2. Can 501(c)(6) chambers of commerce support/oppose candidates without the use of a PAC?
3. Are PACs now even necessary, given the Court’s holding that general treasury funds from nonprofits may support/oppose candidates?
4. Will the Court’s holding extend to all nonprofits (condominium boards of directors, etc.)? Since nonprofits are state-based, a good review of the impact of the case on state election laws may be found at the web site for the National Conference of State Legislatures (www.ncsl.org).

CONCLUSION

The history of nonprofit incorporation within a State, then application to the IRS for exemption from income tax so that the organization could do well, and do good, at the same time required that no tax-free monies interfere with the political process. This became increasingly important with the acquisition of corporations by foreign investors. Today, that history seems to be in question. Only future Court challenges will sort it out. In the meantime, consult with counsel before you send that corporate check to campaign headquarters.

²⁵ U.S. Const. amend. I.

²⁶ Citizens United, 130 S. Ct at 885 (citing Buckley v. Valeo, 424 U.S. 1 (1976), and First National Bank of Boston v. Bellotti, 435 U.S. 765 (1978)).