

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Index (UIL) No.: 4955.04-00

Area Manager

T:EO

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Year Involved:

Date of Conference:

LEGEND:

X =

Y =

Z =

B =

ISSUES:

1. Whether X's administration of a payroll deduction plan that allows employees to contribute to a hospital industry political action committee described in section 527 of the Code constitutes participation or intervention in a political campaign prohibited by section 501(c)(3).

2. If X has intervened in a political campaign, should the excise tax under section 4955 of the Code be imposed?

FACTS:

X (System) is a non-profit corporation exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) and is not a private foundation because it is a supporting organization described in section 509(a)(3). During , System was the parent corporation of corporations providing health care services. B became President and CEO of System in and continues to

Area Manager-Gulf Coast

serve in that position today. On December 10, 1998, the Service notified System that it intended to examine System's fiscal year ending October 31, as part of a coordinated examination.

Y is a trade association representing over hospitals and health systems, and is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(6). Z is a political action committee described in section 527, which was organized by Y in . Z supports candidates of all political parties for state legislative positions and offices. Z offers a payroll deduction plan (the "Plan") pursuant to which an individual can elect to have a contribution deducted automatically and forwarded to Z. System has made the Plan available to its employees for many years. Prior to the year almost all system participants were management employees.

B has been an active participant in Y. During the tax year, he was elected Chairman of the Board of Trustees, a position he held until June . In his capacity as Chairman, B announced that he would try to achieve certain goals set by Y, including increased participation in Z by Y members. These efforts included education efforts undertaken at the health care organizations affiliated with System and the continued offering of a payroll deduction plan for employees within System who desired to use payroll deductions as a vehicle to contribute to Z.

In November, , System began an effort to make all System and system-affiliate employees aware of their ability to participate in Z through payroll deduction. During regularly scheduled meetings, department heads and the management for System affiliates briefly discussed the Plan. Managers were asked to develop a simple and efficient method of informing employees they had a right to participate in Z through payroll deduction. A video that featured B explaining the impact of political input on the hospital industry was distributed to managers for use in communicating with employees. Donation cards were made available to employees at the meetings and managers were encouraged to get a signed form from each employee, irrespective of the employee's decision to participate, in order to avoid duplicative efforts. Employees were told that their participation in the Plan was strictly voluntary. The cards included an option to decline participation in the Plan. Representatives of Z were not present at the meetings.

Employees were also informed about the availability of the Plan in an edition of System's employee newsletter distributed in January, , which included Z's Donation and Payroll Deduction Form.

Of a total of System employees, approximately , returned the Payroll Deduction Cards and approximately chose to participate in the Plan.

Area Manager-Gulf Coast

The methods of communication developed by System management varied somewhat between hospitals, departments and service areas. The vast majority of managers used regularly scheduled meetings and simply added Z information as an agenda item, although managers of smaller departments talked to employees on an individual basis the hall or at their desks. A limited number of managers called brief meetings exclusively to discuss the Plan. Presentation of the Z information took anywhere from five minutes, if managers only discussed the opportunity verbally and did not show the video, to 10 minutes if the video was shown. Thus, the average communication is estimated to have been 8 minutes per employee.

System states that the incremental costs of providing this information to the employees were accounted for and invoiced to Z. The incremental costs invoiced to Z included the printing of the Z Payroll Deduction cards and production of the video and video cassette duplicates. According to System, all other costs were not incremental. No overtime was paid, no additional staffing was required, and refreshments were not generally served. In one facility, donuts were provided and the cost was invoiced to Z.

In addition to the meetings, two other areas have been identified as related expenses. These were the cost of B time to make the video and the cost to produce and distribute the portion of the newsletter devoted to Z. System's response is that Mr. B is a salaried employee and does not utilize a time clock or have a regimented work schedule. Therefore, B's participation in the video did not create any incremental cost to the organization. It was seen as a cost efficient way to allow B to let employees know about the Z opportunity without having to attend scores of meetings. As for the newsletter, System provided the following information: The cost of printing the newsletter was approximately \$. The employee that produces the newsletter spends about 5 hours each month and the cost of her time is estimated at between and \$ per issue. About 20% of the January edition was devoted to Z. Costs were not billed to Z because they were not viewed as incremental.

System raised \$ for Z during . This amount came from either payroll deduction or direct cash from the employees. The total amount of payroll deduction withheld and paid over to Z in was \$, consisting of in cash and payroll deductions and a \$ corporate contribution that went to Z's education fund and not to the candidate contribution section of Z. The employee contribution to Z in is estimated at based on current employee requests for payroll deduction.

Employees who contributed at least per year to Z were entitled to receive the quarterly Z newsletter and Z's endorsement newsletters.

Area Manager

LAW:

Section 501(a) of the Code provides for the exemption from federal income tax of organizations described in section 501(c)(3).

Section 501(c)(3) of the Code provides, in part, for the exemption of organizations that are organized and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Section 1.501(c)(3)-1(c)(3)(i) of the Income Tax Regulations (regulations) provides that an "action" organization described in section 1.501(c)(3)-1(c)(3)(iii) is not described in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(c)(3)(iii) of the regulations provides that:

an organization is an "action" organization if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. The term "candidate for public office" means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state, or local. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such a candidate.

Rev. Rul. 62-156, 1962-2 C.B. 47 considers whether the administration and operation of a payroll deduction plan necessarily involves use of the employer's resources and assets, as a determinable cost to the employer. In that case, an employer incurred certain costs involved in promoting the involvement of its employees in the political process. Advertisements encouraging persons to vote were published, employees were given time off with pay to vote, and a payroll deduction plan allowing contributions to any political entity was established. In ruling that these expenditures were deductible as ordinary and necessary business expenses, the Service recognized that the expenses related to the employee programs were justified in that, among other things they improved employee morale and enhanced the reputation of the employer.

Area Manager

Rev. Rul. 78-248, 1978-1 C.B. 154, describes certain "voter education" activities conducted by organizations that otherwise qualify for exemption under section 501(c)(3) of the Code. The Rev. Rul. describes four situations concerning organizations involved in voter "educational" activities. Situations 1 and 2 involve organizations providing unbiased information on a wide variety of issues. Situations 3 and 4 involve organizations that are slanting the information provided or focusing on narrow issues. The Rev. Rul. states that the first two organizations are not violating the prohibition against political activity. The organizations described in Situations 3 and 4 will not qualify for exemption because of their political activities. None of the four situations involves an organization directly endorsing a candidate for office.

Section 4955 of the Code provides for taxes on political expenditures of section 501(c)(3) organizations. Section 4955 (d)(1) provides, in general, that the term "political expenditure" means any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Section 4955(a)(1) of the Code imposes a tax of 10 percent of the amount of such political expenditures. This tax is imposed on the 501(c)(3) organization. Section 4955 (a)(2) imposes on the agreement of any organization manager to the making of any expenditure, knowing that it is a political expenditure, a tax equal to 2½ percent of the amount thereof, unless such agreement is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any organization manager who agreed to the making of the expenditure. Section 4955(b) imposes additional taxes on any organization where the initial tax is imposed and the expenditure is not corrected within the taxable period and on any manager who refuses to agree to part of all of the correction.

Section 4955(f)(3) provides that the terms "correction" and "correct" mean, with respect to any political expenditure, recovering part or all of the expenditure to the extent recovery is possible, establishment of safeguards to prevent future political expenditures, and where full recovery is not possible, such additional corrective action as is prescribed by the Secretary by regulations.

DISCUSSION:

The regulations provide that activities constituting participation or intervention in a political campaign include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in

Area Manager

opposition to a candidate for public office. Consequently, a written or oral endorsement of a candidate is strictly forbidden. The rating of candidates even on a non-partisan basis, also is prohibited, See Association of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), cert. denied, 490 U.S. 1030 (1989).

While there is no evidence System has endorsed or rated candidates for public office, section 501(c)(3) organizations may not do indirectly what they cannot do directly. Therefore, they may not provide or solicit financial or other forms of support to political organizations, or establish political action committees.

By implicitly endorsing Z and soliciting financial support of Z at regularly scheduled employee meetings and implicitly endorsing Z in its employee newsletter, System has indirectly intervened in political campaigns. Z exists to endorse and support hospital industry-backed candidates.

System relies on Rev. Rul. 62-156 for the proposition that its payroll deduction plan is not prohibited political activity, but merely a way of improving employee morale. An important distinction, however, is that in Rev. Rul. 62-156, the recipient PACs were of the employees' choosing. In this case, the PAC is selected and endorsed by the employer who has a vested interest in electing candidates who share its "vision and priorities for healthcare." Z was the only choice for the employees.

The prohibition on political campaign activity applies only to section 501(c)(3) organizations, not to the activities of individuals in their private capacity. The prohibition against political campaign activity does not prevent an organization's officials from being involved in a political campaign so long as those officials do not in any way utilize the organization's financial resources, facilities, or personnel, and clearly and unambiguously indicate that the actions taken or the statements made are those of the individuals and not of the organization.

On the other hand, since a section 501(c)(3) organization acts through individuals, sometimes the political activity of an individual may be attributed to the organization. As in other situations where the political campaign prohibition is concerned, the determination of whether the act of an individual will be attributed to a section 501(c)(3) organization is based on the relevant facts and circumstances. In particular, when officials of a section 501(c)(3) organization engage in political activity at official functions of the organization or through the organization's official publications, the actions of the officials are attributed to the section 501(c)(3) organization. Use of the section 501(c)(3) organizations' financial resources, facilities or personnel is also indicative that the actions of the individual should be attributed to the organization.

Applying the standards described above, the video is essentially an endorsement

- 7 -

Area Manager

of Z by System through the its CEO, B. Nowhere in the video does B distance himself from System or make clear that his statements are his and not System's. He introduces himself as follows: "Hello. I'm [B], president and CEO of the [X]." Moreover, the video was produced on company time using company resources and facilities and shown at regularly scheduled employee meetings. Therefore, System has indirectly participated or intervened in a political campaign by administering the payroll deduction plan on behalf of Z. All expenditures for the administration of the payroll deduction plan are therefore political expenditures within the meaning of section 4955 of the Code and subject to the excise tax.

CONCLUSION:

1. System's administration of a payroll deduction plan that allows employees to contribute to a hospital industry political action committee described in section 527 of the Code constitutes participation or intervention in a political campaign prohibited by section 501(c)(3).
2. The excise tax under section 4955 should be imposed.

A copy of the technical advice memorandum is to be given to the organization. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

-END-