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The Section 527 Obstacle to Meaningful Section 501(c)(4) Regulation

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The Section 527 Obstacle to Meaningful Section 501(c)(4) Regulation

Ellen P. Aprill

(forthcoming Pittsburgh Tax Review)

As is well known, on May 10, 2013, at a session of the American Bar Association Tax Section meeting in Washington, D.C., Lois Lerner, at the time the director of the Exempt Organization Division of the Internal Revenue Service (IRS or Service), apologized for IRS mishandling of applications by Tea Party groups for exemption as social welfare groups under section 501(c)(4) of the Internal Revenue Code.¹ A few days later, the Department of the Treasury (Treasury) Inspector General released a report (TIGTA Report) concluding that the “IRS used inappropriate criteria that identified for review Tea Party and other organizations applying for tax-exempt status based upon their names or policy positions instead of indications of potential political campaign intervention.”²

Current tax law limits the amount of political campaign intervention social welfare organizations may conduct. Section 501(c)(4) of the Internal Revenue Code specifies that organizations exempt as social welfare organizations under that provision must be operated

¹I.R.C. § 501(c)(4) (2012); Fred Stokeld, *IRS Sparks Outrage with Admission It Mistreated Tea Party Groups*, TAX NOTES TODAY, May 13, 2013, available at LEXIS, 2013 TNT 92-3. References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code” or the “Internal Revenue Code”) unless otherwise indicated.

²INSPECTOR GEN. FOR TAX ADMIN., DEP’T OF TREASURY, 2013-10-053, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW (2013), available at <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf>. I will use the term “political campaign intervention” to refer in general to this activity; I will limit the term “candidate-related political activity” introduced in the 2013 Proposed Regulation, to discussion of the 2013 Proposed Regulation. See Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71535 (Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

“exclusively for the promotion of social welfare.”³ Treas. Reg. § 1.501(c)(4)–1, however, states, “An organization is operated exclusively for the promotion of social welfare if it is *primarily* engaged in promoting, in some way, the common good and general welfare of the people of the community.”⁴ The statutory language for section 501(c)(4) makes no reference to political campaign intervention,⁵ but the regulation further specifies that “promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office”⁶—that is, political campaign intervention.

Although nonprecedential statements and common practice suggest that political campaign intervention can go up to 49% of activity, nowhere has the IRS ever defined what constitutes primary activity.⁷ The TIGTA Report called for the Exempt Organizations Division to recommend to the IRS Office of Chief Counsel and the Department of Treasury that guidance on how to measure “primary activity” for section 501(c)(4) organizations be included in the Department of Treasury Priority Guidance Plan.⁸ The National Taxpayer Advocate made a similar recommendation in a June 30, 2013 special report to Congress on the issue.⁹

³I.R.C. § 501(c)(4)(A). This exemption dates back to 1913, the original enactment of the federal income tax. See Tariff Act of 1913, ch.16, 38 Stat. 114 (1913).

⁴Treas. Reg. § 1.501(c)(4)–1(a)(2)(i) (as amended in 1990) (emphasis added).

⁵In contrast, in order to qualify as a tax-exempt charity under section 501(c)(3), an organization must 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.”

⁶Treas. Reg. § 1.501(c)(4)–1(a)(2)(ii).

⁷For example, the then Director of the IRS’s Exempt Organization Division indicated of section 501(c)(4) organizations that “[w]hen it comes to political activities, that is, giving money to a candidate, and telling people to vote for a certain candidate, the rule is that it has to be less than primary. If it’s 49 percent of their income, that is less than primary.” Marcus Owens, *Practicing Law Institute Program on Corporate Political Activities*, 3 EXEMPT ORG. TAX REV. 471 (1990). See also *EO Materials Suggest 51 Percent Threshold for 501(c)(4) Groups*, 142 TAX NOTES 394 (Jan. 27, 2014); *Judy Kindell on § 501(c)(4)-(6) Organizations and § 527*, 11 PAUL STRECKFUS’S EO TAX J. 42, 45 (2006).

⁸TIGTA Report at 17.

⁹National Taxpayer Advocate, *Special Report to Congress: Political Activity and the Rights of Applicants for Tax-Exempt Status*, 14-15, available at <http://www.taxpayeradvocate.irs.gov/userfiles/file/FullReport/Special-Report.pdf>.

On November 29, 2013, the Treasury and the Service issued a Notice of Proposed Rulemaking¹⁰ containing proposed Treas. Reg. § 1.501(c)(4)-1 (the “2013 Proposed Regulation”) regarding the activities of organizations exempt under section 501(c)(4). The 2013 Proposed Regulation, however, did not offer any guidance on how to measure “primary activity” for section 501(c)(4) organizations. Instead, the 2013 Proposed Regulation offered only a definition of a new category, “candidate related-political activity,” although it also asked for comment on a dozen issues.¹¹

The 2013 Proposed Regulation prompted a record number of comments on a proposed tax regulation – just under 170,000.¹² On May 22, 2014, the IRS announced that it and the Treasury Department would be making changes to the 2013 Proposed Regulation in light of the comments received.¹³ During an interview on June 18, 2014 with the Center for Public Integrity, IRS Commissioner John Koskinen stated that he expected revised regulations to be ready in early 2015 and that they would address not only definitional issues, but also the amount of political campaign intervention permitted and to what organizations the rules would apply.¹⁴ Although no revised regulation was issued in early 2015, the Office of Information and Regulatory Affairs of

¹⁰Notice of Proposed Rulemaking, “Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities,” 78 Fed. Reg. 71535 (Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

¹¹See *infra* at <http://www.regulations.gov#!docketDetail;D=IRS-2013-0038>

¹²As of July 14, 2014, the exact number was 169,013. I do not claim to have read even a large percentage of the comments, but have tried to read many of the comments submitted from well-known organizations. Because this piece will emphasize the interaction of sections 527 and 501(c), I note that, in 2004, when the Federal Election Commission proposed a rule to treat section 527 organizations as political committees under the Federal Election Campaign Act in certain situations, it received more than 150,000 comments, a number in the same ballpark. See Richard Briffault, *The 527 Problem . . . and the Buckley Problem*, 73 GEORGE WASH. L. REV. 1701, 1704 (2005). Ultimately, the FEC did not adopt such a rule. *Id.*

¹³I.R.S., IRS UPDATE ON THE PROPOSED NEW REGULATION ON 501(c)(4) ORGANIZATIONS (2014), available at [http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501\(c\)\(4\)-Organizations](http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations).

¹⁴See Julie Patel, *IRA Chief Promises Stricter Rules for ‘Dark Money’ nonprofit groups*, THE CENTER FOR PUBLIC INTEGRITY (Nov. 20, 2014, 5:00 PM), <http://www.publicintegrity.org/2014/06/18/14960/irs-chief-promises-stricter-rules-dark-money-nonprofit-groups>; *New 501(c)(4) Regs Should Drop by Early 2015, Koskinen Says*, 2014 TAX NOTES TODAY 118-5 (June 19, 2014). Section 501(c)(5) unions and section 501(c)(6) business leagues have already expressed objection to any extension to their categories. See Paul C. Barton, *Unions Say History Endorses Their Political Role*, 2014 TAX NOTES TODAY 247-4 (Dec. 24, 2015); Paul C. Barton, *Wider IRS Nonprofit Rules Likely to Anger Trade Groups*, 2014 TAX NOTES TODAY 219-5 (Nov. 13, 2014).

the Office of Management and Budget scheduled publication of a revised section 501(c)(4) proposed regulation for June, 2015.¹⁵ On June 15, however, at the annual meeting of the AICPA Not-for-Profit Industry Conference, Ruth Madrigal, Attorney-Advisor in the Office of Tax Policy in the Department of the Treasury, discouraged expectation of a June release.¹⁶ The New York Times reported in mid-July, 2015 that revised regulations will not be issued until after the 2016 election.¹⁷ Speaking to a House committee on July 23, 2015, IRS Commissioner Koskinen confirmed that revised regulations would not be issued prior to the 2016 election.¹⁸ He explained to reporters after the hearing, “I don’t want people thinking we are trying to get these regs done so we can influence the election.”¹⁹

To state a truism, regulation of politics inevitably becomes political. Even in the absence of the Tea Party controversy, developing regulation regarding what and how much political campaign intervention is permitted for tax-exempt entities would present a daunting issue for tax administrators. However Treasury and the IRS revise the 2013 Proposed Regulation, they are sure to face opposition and controversy from many sides, including members of Congress.²⁰

¹⁵See <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201504&RIN=1545-BL81>.

¹⁶See EO Tax Journal 2015-116 (June 16, 2015) (on file with author).

¹⁷Eric Lichtblau, *I.R.S. Expected to Stand Aside as Nonprofits Increase Role in 2016 Race*, N.Y. TIMES, July 6, 2015, at A13, available at <http://www.nytimes.com/2015/07/06/us/politics/irs-expected-to-stand-aside-as-nonprofits-increase-role-in-2016-race.html>; Nicholas Confessore, *Nonprofit Group Tied to Rubio Raises Millions While Shielding Donors*, N.Y. TIMES, July 7, 2015, at A17, available at <http://www.nytimes.com/politics/first-draft/2015/07/06/group-supporting-marco-rubio-raises-16-million-as-donors-are-shielded/>.

¹⁸Editorial Board, *The I.R.S. Gives Up on ‘Dark Money,’* N.Y. TIMES, Sunday Review Editorial, July 25, 2015, available at <http://www.nytimes.com/2015/07/26/opinion/sunday/the-irs-gives-up-on-dark-money.html>.

¹⁹*Id.* The New York Times editorial criticized the IRS sharply for this decision: “It is a gross insult to taxpayers to make them underwrite the brazen evasions of campaign operatives bundling dark money. The abuse is compounded by the latest I.R.S. retreat from its responsibility” *Id.*

²⁰Prior to Koskinen’s July 23 statement, Republican members of Congress sought to delay by legislation until at least 2018 any new regulation regarding the campaign intervention activities of section 501(c)(4) organizations. See *IRS Should Reject Political Activity Proposal, Hatch Says*, 2015 TAX NOTES TODAY 71-24 (April 13, 2015); Paul C. Barton, *Republicans Again Seek Delay in Rulemaking on Nonprofits*, 146 TAX NOTES 588 (FEB. 2, 2015); *H.R. 599 Would Bar Changing of Exempt Group Standards*, 2015 TAX NOTES TODAY 20-23 (January 20, 2015); *S. 283 Would Bar IRS from Changing Exempt Groups Standards*, 2015 TAX NOTES TODAY 20-22 (January 30, 2015); Editorial, *Dark Money’s Deepening Power*, N.Y. TIMES (June 29, 2015), available at <http://www.nytimes.com/2015/06/29/opinion/dark-moneys-deepening-power.html?ref=politics>.

This paper argues that, despite their best efforts, the Treasury and IRS will be unable to propose a regulation that will satisfy critics either on the left or on the right because of a structural issue -- the existence and operation of section 527 of the Internal Revenue Code, the provision defining, regulating, and taxing political organizations.²¹ Section 527, in general, shields the “exempt function income” of political organization from taxation. Exempt income is defined as contributions and other funds raised for political purposes.²² However, any exempt organization that expends funds for an exempt function must pay tax on the lesser of its net investment income or the amount it spends on political campaign intervention.²³

In my view, regulation of political campaign intervention by section 501(c)(4) and other section 501(c) organizations cannot function well without establishing meaningful limits, and I believe that section 527 hamstring the IRS in setting limits for such activity by section 501(c) organizations.²⁴ That is, I reluctantly agree with the point Commissioner Koskinen made when speaking to reporters on March 24, 2015: “The framework Congress has is you get to pick where you want to be. . . . If you spend, at this point, less than 49 percent of your money on politics, you can be a (c)(4). . . . if you want to spend all of your money on politics, or more than 50 percent of it, the Congress has provided [section 527] as a place where you can land.”²⁵

In order to permit better and more consistent regulation of political campaign intervention, this paper proposes a number of changes to section 527, including moving responsibility for

²¹A political organization is defined as “a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purposes of directly or indirectly accepting contribution or making expenditures, or both, for an exempt function. § 527(e)(1). As discussed *infra* at, not all commentators agree with my conclusion regarding the interaction of these sections.

²²§ 527(e)(2). Although political campaign intervention under section 501(f) and exempt function differ in some details, I will treat the categories as identical and point out differences if and when relevant.

²³§ 527(f).

²⁴This piece considers only statutory, not constitutional arguments. For a discussion of the constitutional issues, see Ellen P. Aprill, *Regulating the Political Speech of Nonprofit Noncharitable Exempt Organizations after Citizens United*, 10 ELECTION L.J. 363, 398 (2011) (*hereinafter*, Aprill, *Regulating Political Speech*).

²⁵Paul C. Barton, *Koskinen’s Comment on Political Spending of Nonprofit Disputed*, 147 TAX NOTES 31 (April 6, 2015). Not all agree with the Commissioner’s assessment. *Id.* See also text *infra* at notes [later discussion of exclusively]

disclosure to the Federal Election Commission [FEC].²⁶ It further suggests that section 527(f) be eliminated and that all organizations, including section 501(c) organizations, be permitted to engage in political campaign intervention only through separate section 527 organizations to which contributions must be made directly.²⁷ With such changes, political campaign intervention would be prohibited for all section 501(c) organizations. Given the fate of the DISCLOSE Act,²⁸ which in general would require disclosure of donors who make contributions that could be used for political campaign intervention by nonprofit organizations, I do not have any expectation that such changes would be enacted any time soon. I argue, however, that such changes are needed to permit coherent regulation of political campaign intervention by section 501(c) organizations.

Part I summarizes the 2013 Proposed Regulation. Part II describes section 527. Part III discusses the difficulties of their interaction. Part IV concludes with recommendations for change.

I. Summary of the 2013 Proposed Regulation

The 2013 Proposed Regulation would amend Treas. Reg. §1.501(c)(4)–1(a)(2)(ii) to delete the current reference to “direct or indirect participation or intervention in political campaigns on

²⁶As explained further *infra*, this conclusion is the same as Lloyd Hitoshi Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625 (2007), and his more recent piece, Lloyd Hitoshi Mayer, *Regulating Politics, Taxing Politics* (available from author, quoted with permission), but it reaches this conclusion via a different route.

²⁷As explained further *infra*, this position closely resembles the comments of Professors Don Tobin and Brian Galle and the Bright Line Project on the 2013 Proposed Regulation as well as suggestions in recent scholarly work of others. See Comments of Brian Galle and Donald Tobin [http://www.regulations.gov/#!searchResults;rpp=25;po=0;s=Galle%252Band%252BTobin%252Band%252B501\(c\)\(4\);dct=PS](http://www.regulations.gov/#!searchResults;rpp=25;po=0;s=Galle%252Band%252BTobin%252Band%252B501(c)(4);dct=PS), Comment from Emily Peterson-Cassin, the Bright Line Project, <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-135554>; Lloyd Hitoshi Mayer, Lloyd Hitoshi Mayer, *Regulating Politics, Taxing Politics* (available from author); Roger Colinvaux, *Political Activity and Tax Exemption: A Gordian Knot*, 34 VA. TAX REV. 1, 29-33 (2014). Also as explained *infra*, my preference is that all political campaign intervention take place through section 527 organizations that have raised funds for that purpose. I do, however, consider Prof. Mayer’s suggestion that noncharitable exempt organizations be allowed an insubstantial amount of political campaign intervention.

²⁸The Democracy Is Strengthened by Casting Light on Spending in Elections Act (DISCLOSE) was first introduced in 2010 (H.R. 5175 and S.3628). Its most recent iteration, the Disclose Act of 2015, was introduced by Senator Whitehouse in January 2015 and referred to committee. See <https://www.congress.gov/bill/114th-congress/senate-bill/229/text>. No further action has been taken.

behalf of or in opposition to any candidate for public office,” language that closely resembles the definition of political campaign intervention in the section 501(c)(3) statute and regulations. The 2013 Proposed Regulation, drawing from section 527 and federal election law, instead posits that “[t]he promotion of social welfare does not include direct or indirect candidate-related political activity,” thus introducing the new term “candidate-related political activity.”²⁹

The 2013 Proposed Regulation provides that candidate-related political activity includes activities that the IRS has traditionally considered to be political campaign activity per se, such as contributions to candidates and communications that expressly advocate for the election or defeat of a candidate. In defining candidate-related political activity for purposes of section 501(c)(4), however, the 2013 Proposed Regulation also draws key concepts from the federal election campaign laws, with some modifications. For example, the 2013 Proposed Regulation also would treat as candidate-related political activity certain activities that, because they occur close in time to an election or are election-related, have a greater potential to affect the outcome of an election.³⁰

Consistent with the scope of section 527, the 2013 Proposed Regulation specifies that “candidate” means an individual who identifies himself or is proposed by another for selection, nomination, election, or appointment to any public office or office in a political organization, or to be a Presidential or Vice-Presidential elector, whether or not the individual is ultimately selected, nominated, elected, or appointed. In addition, the 2013 Proposed Regulation clarifies that for these purposes the term “candidate” also includes any officeholder who is the subject of a recall election. As the Treasury Department and the IRS acknowledge, defining “candidate-

²⁹78 Fed. Reg. at 71537-38.

³⁰78 Fed. Reg. at 71538-39.

related political activity” in the 2013 Proposed Regulation to include activities related to candidates for a broader range of offices (such as activities relating to the appointment or confirmation of executive branch officials and judicial nominees) is a significant change.³¹ Historically, political campaign intervention for section 501(c)(4) organizations has been defined, as it has for section 501(c)(3) organizations as applying only to elections for public office. The 2013 Proposed Regulation instead would apply a definition that reflects the broader scope of section 527.³²

Under the 2013 Proposed Regulation, candidate-related political activity includes communications that expressly advocate for or against a candidate. The 2013 Proposed Regulation draws from Federal Election Commission rules in defining “expressly advocate.” The Proposed Regulation enlarges this meaning of express advocacy to include communications expressing a view on the selection, nomination, or appointment of individuals, or on the election or defeat of one or more candidates or of candidates of a political party.³³ Under the 2013 Proposed Regulation, all communications – including written, printed, electronic (including Internet), video, and oral communications – that express a view, whether for or against, on a clearly identified candidate (or on candidates of a political party) would constitute candidate-related political activity. Clear identification in a communication includes name, photograph, or reference (such as “the incumbent” or a reference to a particular issue or characteristic distinguishing the candidate from others).³⁴ The 2013 Proposed Regulation also provides that candidate-related political activity includes “any express advocacy communication the

³¹78 Fed. Reg. at 71538.

³²Some section 501(c)(4) are already subject to this broader section 527 definition. If a section 527 organization engages in political campaign intervention as defined in section 527, it may be subject to tax under section 527(f).

³³78 Fed. Reg. at 71538-39.

³⁴*Id.*

expenditures for which an organization reports to the Federal Election Commission under the Federal Election Campaign Act as an independent expenditure.”³⁵

Under the proposed definition, candidate-related political activity would encompass any public communication that is made within 60 days before a general election or 30 days before a primary election and that clearly identifies a candidate for public office (or, in the case of a general election, refers to a political party represented in that election).³⁶ The 2013 Proposed Regulation borrows these time frames from those appearing in the Federal Election Campaign Act definition of electioneering communications.³⁷ The 2013 Proposed Regulation defines “election,” including what would be treated as a primary or a general election, to be consistent with section 527(j) and the federal election campaign laws.³⁸ A “public” communication is one made using certain mass media (specifically, by broadcast, in a newspaper, or on the Internet), constitutes paid advertising, or reaches or is intended to reach at least 500 people (including mass mailings or telephone banks).³⁹ The 2013 Proposed Regulation also provides that candidate-related political activity includes any communication the expenditures for which an organization reports to the Federal Election Commission under the Federal Election Campaign Act, including electioneering communications.⁴⁰

The definition of candidate-related political activity in the 2013 Proposed Regulation would include “contributions of money or anything of value to or the solicitation of contributions

³⁵78 Fed. Reg. at 71538.

³⁶78 Fed. Reg. at 71539.

³⁷*Id.*

³⁸*Id.*

³⁹*Id.*

⁴⁰*Id.* An electioneering communication under the federal election laws is one that refers to a clearly identified federal candidate, is distributed by a television station, radio station, cable television system or satellite system for a fee; and is distributed within 60 days prior to a general election or 30 days prior to a primary election to public office. See <http://www.fec.gov/finance/disclosure/electioneering.shtml>.

on behalf of (1) any person if such contribution is recognized under applicable federal, state, or local campaign finance law as a reportable contribution; (2) any political party, political committee, or other section 527 organization; or (3) any organization described in section 501(c) that engages in candidate-related political activity,” a definition of contribution similar to the definition of contribution that applies for purposes of section 527.⁴¹ The term “anything of value” would include both in-kind donations and other support (for example, volunteer hours and free or discounted rentals of facilities, or mailing lists).⁴² The 2013 Proposed Regulation provides that, for purposes of this definition, “a recipient organization would not be treated as a section 501(c) organization engaged in candidate-related political activity if the contributor organization obtains a written representation from an authorized officer of the recipient organization stating that the recipient organization does not engage in any such activity and the contribution is subject to a written restriction that it not be used for candidate-related political activity.”⁴³ This safe harbor requires that the contributor organization not know, or have reason to know, that the representation is inaccurate or unreliable.

An especially controversial provision of the 2013 Proposed Regulation defines candidate-related political activity to include certain specified election-related activities, including the conduct of voter registration and get-out-the-vote drives, distribution of material prepared by or on behalf of a candidate or section 527 organization, and preparation or distribution of a voter guide and accompanying material that refers to a candidate or a political party.⁴⁴ The 2013 Proposed Regulation provides that activities conducted by an organization include, but are not limited to,”(1) activities paid for by the organization or conducted by the organization’s officers,

⁴¹78 Fed. Reg. at 71539.

⁴²*Id.*

⁴³*Id.*

⁴⁴78 Fed. Reg. at 71539-40.

directors, or employees acting in that capacity, or by volunteers acting under the organization's direction or supervision; (2) communications made (whether or not such communications were previously scheduled) as part of the program at an official function of the organization or in an official publication of the organization; and (3) other communications (such as television advertisements) the creation or distribution of which is paid for by the organization.⁴⁵ Under the 2013 Proposed Regulation, an organization's Web site is an official publication of the organization; thus, under the 2013 Proposed Regulation material posted by the organization on its Web site may constitute candidate-related political activity.⁴⁶

Quoting from the ABA Tax Section comments,⁴⁷ the 2013 Proposed Regulation sought public comment on 12 specific issues:⁴⁸

- The advisability of adopting a similar approach to the Proposed Regulation for section 501(c)(3) organizations, either in lieu of facts and circumstances, or in adding presumptions or safe harbors, and what modifications would be needed in the section 501(c)(3) context.
- The advisability of adopting a similar approach to the Proposed Regulation to define section 527 exempt function activity, in lieu of facts and circumstances.
- The advisability of adopting the Proposed Regulation's approach to defining activities that do not further the exempt purposes of section 501(c)(5) and (6) organizations.
- What proportion of an organization's activities must promote social welfare to qualify for exemption under section 501(c)(4), and whether additional limits should be imposed on an organization's non-social-welfare activities.
- How to measure the activities of a section 501(c)(4) organization for purposes of applying the proportion-of-activities test.

⁴⁵78 Fed. Reg. at 71540.

⁴⁶*Id.*

⁴⁷Michael Hirschfeld, ABA Section of Taxation, *Comment on the Internal Revenue Service (IRS) Proposed Rule: Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* (May 7, 2014), Text following footnote 7, (May 7, 2014) (hereinafter "Comments of the ABA Tax Section"), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-14385.5>

Because the ABA Tax Section comments as submitted lacked page numbers, I will instead cite to the version of the comments on the Tax Section's webpage:

<http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/050714comments.authcheckdam.pdf>

The author participated in the drafting of these comments, but did not draft any portion of the comments discussed in this article.

⁴⁸ABA Tax Section Comments, *supra*, at ii-iii.

- Whether the length of the pre-election period during which certain public communications defined in the Proposed Regulation are automatically treated as candidate-related political activity should be shorter or longer, and whether there should be exceptions for certain communications during the window.
- Whether the pre-election-window approach in the Proposed Regulation should apply to the period before an appointment, confirmation, or other selection event other than an election.
- Whether transfers other than those defined in the Proposed Regulation, such as indirect contributions to political parties or candidates under section 276, should be treated as candidate-related political activity.
- Whether any exceptions to the definition of candidate-related political activities are needed for voter education activities.
- Whether and under what circumstances material posted by a third party on an interactive part of an organization's web site should be attributed to the organization.
- Whether an organization's responsibility for linking to a third party's web site should be the same for purposes of candidate-related political activity as for section 501(c)(3) organizations under existing guidance.
- Whether other activities should be included in, or excepted from, the definition of candidate-related political activity.

As indicated by the Commissioner's remarks quoted above, it appears that coverage of any revised proposal will apply as well to other types of section 501(c) organizations, the amount of political campaign intervention to be allowed, and how to measure political campaign intervention. I note that many comments expressed particular dismay at the 2013 Proposed Regulation's treatment of nonpartisan efforts – including get out the vote, voter registration, candidate debates close to an election, and voter guides – as candidate-related political activity.⁴⁹

II. Section 527

⁴⁹See, e.g., Comments of ABA Section of Taxation, *supra*, at 12-13; NAACP, <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-126091>, text at notes 3-9; Comments of the Alliance for Justice, pages 2-4; <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-124817>; Comments of the Bipartisan National Advocacy Groups, at p. 2; <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-123301>; Comments of American Civil Liberties Union, at pp. 16-20, <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-21490>.

Prior to the 1974 Congressional codification of the treatment of political organizations in section 527, the IRS struggled with how to treat political organizations.⁵⁰ Congressional action in 1974 codified the taxation of political organizations by enacting section 527 and related provisions. Both the Senate Finance and House Ways and Means Committee Reports explained that “the questions involved in the area require a delicate balance between the need to protect the revenue and of the need to encourage political activities which are the heart of the democratic process.”⁵¹ Committee Reports assumed that the IRS had historically not required the filing of income tax returns from political organization on the basis that “the receipts of political organizations were from gifts,”⁵² reasoning the IRS in fact had rejected.⁵³ The Congressional committees concluded that “political activity (including the financing of political activity) as such is not a trade or business which is appropriately subject to tax.”⁵⁴ Like the IRS, Congress decided that any income from investment, less direct expenses incurred in earning that income, should be subject to tax.

As codified, section 527 defined a number of terms, clarified and, in some cases, expanded the IRS decisions. “Political organization” was defined as “a party, committee, association, fund or other organization (whether or not incorporated) organized and primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.”⁵⁵ An entity that met this definition was a political organization under section 527, subject to tax only to the extent provided in section 527, and considered an organization exempt

⁵⁰This section draws heavily from an earlier article by the author: Ellen P. Aprill, *Regulating the Political Speech of Nonprofit Noncharitable Exempt Organizations after Citizens United*, 10 ELECTION L.J. 363, 398 (2011). That article gives further detail on the IRS struggles prior to 1974.

⁵¹S. Rep. No. 1357, at 25 (1974).

⁵²*Id.*

⁵³*Id.*

⁵⁴*Id.*

⁵⁵Act of Jan 3, 1975, Pub. L. No. 93-625, 88 Stat. 2108, 2117 (1975) (codified as I.R.C. § 527 (e)(1)).

from income taxes under section 527(a). There was no requirement that the organization apply for exemption; neither was the classification voluntary, except by meeting the description.⁵⁶

Under section 527 as originally enacted, the taxable income of a political organization was a political organization's gross income, excluding exempt function income, over the deductions directly connected with production of the gross income.⁵⁷ Exempt function income is defined as

the function of influencing or attempting to influence the selection, nomination, election or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected or appointed.⁵⁸

Of particular import for my argument here, Congress also introduced the tax on political activities of section 501(c) entities, which is codified at section 527(f). This aspect of the legislation was intended to treat "these organizations on an equal basis for tax purposes with

⁵⁶FSA 20037040 confirms that section 527 status is not voluntary. As Prof. Colinvaux points out, the FSA was published September 15, 2000, after effective date of 2000 amendments to section 527, but its issue date of June 19 "indicates that its discussion is relevant with respect to the pre-2000 section 527 and nothing in the FSA can be read to the contrary." Roger Colinvaux, *Regulation of Political Organizations and the Red Herring of Tax-Exempt Status* NAT. TAX J. (Sept. 2006) 531, 541 n.23.

⁵⁷§ 527(c). Act of Jan 3, 1975, Pub. L. No. 93-625, 88 Stat. 2108, 2116 (1975).

⁵⁸§ 527(e)(2). Regulations under section 527 elaborate. "Whether an expenditure is for an exempt function depends upon all the facts and circumstances," but "[g]enerally where an organization supports an individual's campaign for public office, the organization's activities and expenditures in furtherance of the individual's election or appointment to that office are for an exempt function of the organization." Treas. Reg. § 1.527-2(c)(1) (2003). Indirect expenses include those necessary to support the directly related expenses, such as expenses for overhead and recordkeeping necessary to allow the organization to be established, to engage in political activities and to solicit contributions. Treas. Reg. § 1.527-2(c)(1) (2003). Examples of section 527 exempt function expenses in the regulations include the expenses of a candidates' voice and speech lessons, the expenditures for tickets to a testimonial dinner, attendance at which is intended to aid a candidate's reelection, and the expenses of financing seminars and conferences intended to influence persons who attend to support individuals to public office whose political philosophy is in harmony with that of the organization. Treas. Reg. § 1.527-(5)(ii), (iv), and (viii) (2003). One revenue ruling concludes that expenditures for an election night party were exempt function expenditures as an "inherent part of the . . . selection process," even though they occurred after the outcome was determined. Rev. Rul. 87-119, 1987-2 C.B. 151. The regulations include two examples of exceptions from the definition of section 527 exempt function. The first is expenditures by a section 501(c) organization in connection with the testimony of its president in response to a written request from a Congressional committee in support of the confirmation of an individual to a cabinet position. Treas. Reg. § 1.527-2(d)(vi) (1999). The other is nonpartisan voter registration and get-out-the vote campaigns, which require that the campaigns "not be specifically identified by the organization with any candidate or political party." Treas. Reg. § 1.527-6(b)(5) (2003).

political organizations”⁵⁹ by taxing them on their investment income to the extent of their political expenditures. (The tax applies to the lower of these two amounts; a noncharitable tax exempt entity that engaged in political expenditures but had no investment income would not owe any tax under section 527). Only after-tax funds are to be used for political campaign intervention. The Senate Committee Report observes in language that now seems to us idealistic or naive:

The committee expects that, generally, a section 501(c) organization that is permitted to engage in political activities would establish a separate organization that would operate primarily as a political organization, and directly receive and disburse all funds related to nomination, etc., activities. In this way, the campaign-type activities would be taken entirely out of the section 501(c) organization, to the benefit both of the organization and the administration of the tax laws.⁶⁰

The Committee Report went on to discuss separate segregated funds only in regard to those required under federal law for corporations or labor organizations otherwise forbidden to make contributions or expenditures in connection with federal elections to public office or to political party office or under similar state laws.

⁵⁹Act of Jan 3, 1975, Pub. L. No. 93-625, 88 Stat. 2108, 2118 (1975). See Gregg D. Polsky, *A Tax Lawyer's Perspective on Section 527 Organizations*, 28 CARDOZO L. REV. 1773 (2007); Gregg D. Polsky & Guy-Uriel E. Charles, *Regulating Section 527 Organizations*, 73 GEO. WASH. L. REV. 1000, 1015-1016 (2005).

⁶⁰S. Rep. No. 93-1357, at 30 (1974). As Professor Frances Hill has written, when section 527 was enacted, “Little thought was given to the relation between section 527 and the new FECA [Federal Election Campaign Act], although there appears to have been at least an implicit assumption that section 527 organizations would be subject to the FECA. One explanation for the minimal requirements for exemption under 527 is that it was assumed that all section 527 organizations would be subject to the limitation under the FECA, which would have made further elaboration of limitations or positive requirements redundant.” Frances R. Hill, *Probing the Limits of Section 527 To Design a New Campaign Finance Vehicle*, 26 EXEMPT ORG. TAX REV. 205, 207 (1999). Statements from Senator Lieberman confirm this insight. Shortly before amendments to section 527, Senator Lieberman wrote, “Section 527 has traditionally been understood to apply only to those organizations that registered as political committees under, and complied with FECA, unless they focused exclusively on state and local political activities.” Senator Joseph Lieberman, *Introduction to Campaign Finance Symposium*, 49 CATH. U. L. REV. 5, 8 (1999). During debates on the amendments he spoke more forcefully, asserting that “section 527 formerly had been generally understood to apply only to those organizations that register as political committees under, and comply with FECA, unless they focus on State or local activities or do not meet certain other specific FECA requirements.” 146 Cong Rec S5995 (June 28 2000).

That is, Congress wrongly anticipated that section 501(c) organizations would almost always establish a separate segregated fund, which need be no more than a bank account, that would be treated as a section 527 organization. The statutory structure, however, allowed for section 501(c) organizations to engage directly in exempt function activity, or political campaign intervention as defined in section 527, so long as they paid any applicable section 527(f) tax.⁶¹

In enacting section 527, Congress largely followed the approach of the IRS regarding political organizations. It allowed the income devoted to political campaign intervention itself to be exempt from income taxation. It taxed other income, but also allowed deductions for producing that income. However, it defined the exempt function income more broadly than the IRS by including within its reach membership fees and proceeds from fundraising events. It introduced taxation of section 501(c) organizations on their expenditures for political campaign intervention to the extent of their investment income.

Over the next two decades Congress made only small changes to section 527. In 1978, for example, proceeds from bingo games became a category of exempt function income,⁶² and the rate of tax on taxable income of political organizations became the highest corporate rate.⁶³

Relying on revenue rulings that defined political campaign intervention for purposes of section 501(c)(3), the IRS in the mid- and late-1990's issued a number of private letter rulings

⁶¹Congress resolved uncertainty about gift tax treatment of contributions to political organizations by enacting section 2501(a)(4), which excepts transfers to political organizations within the meaning of section 527(e)(1) from the gift tax. Congress believed that it was "inappropriate to apply the gift tax to political contribution because the tax system should not be used to reduce or restrict political contributions." S. Rep. No. 93-1357 at 30 (1974). At the same time, Congress provided that transfer of appreciated property to a political organization would be treated as a sale, and stated in the legislative history "if a decedent includes a political organization as a beneficiary of his estate, the amount so transferred is to be included in his estate." S. Rep. No. 93-1357 at 30 (1974). Thus, contributions to section 527 organizations had some protection from gift tax, but did not enjoy the same kind of shelter from transfer tax liability granted to charitable contributions.

⁶²Pub. L. No. 95-502, § 302(a) (1978) (codified as §527(c)(3)(D)).

⁶³Pub. L. No. 96-600, § 301(b)(6) (1979) (codified as 527(b)).

regarding status as a political organization under section 527. These rulings reasoned that activities constituting section 501(c)(3) political campaign intervention would also constitute political campaign intervention (i.e. exempt function) for purposes of section 527.⁶⁴

In each of the section 527 private letter rulings, the IRS accommodated organizations that sought to be classified as section 527 political organizations and honored their intent, however subjective that might seem to be from the redacted rulings. The organizations sought assurance of section 527 classification for reasons related both to tax law and election law. The tax law motivation related to the gift tax. While contributions to section 501(c)(3) organizations are not subject to the gift tax,⁶⁵ such organizations will not be suitable vehicles for those seeking to influence legislation and elections. No code section, however, protects transfers to section 501(c)(4) (or other section 501(c) organizations) from gift tax, and at the time, gift taxation of transfers to section 501(c)(4) organizations was uncertain.⁶⁶ In contrast, contributions to section

⁶⁴To give one example of these rulings, Private Letter Ruling 199925051 acknowledged that some of the material that it intended to distribute and techniques that it may use “resemble the public education, issue advocacy or grass roots lobbying materials and techniques often used by charitable organizations without violating the political prohibition of section 501(c)(3) of the Code.” The organization also stated that it would be active in ballot measure, referenda, and initiatives, all activities traditionally carried on by section 501(c)(4) organizations. The organization, however, represented that it would require each voter education project to be authorized by a board resolution describing the specific electoral goal and with its likelihood of impact substantiated by the opinion of experts, data collected from voter opinion polls, focus groups, and similar means or project planning sessions with campaign consultants, major donors and political functionaries. Because the format, timing, and targeting of voter education and grass roots lobbying would be based on political considerations, the ruling concluded that these activities would be considered section 527 political campaign intervention. In addition to this private letter ruling, the IRS also issued Priv. Ltr. Rul. 98-08-037, Priv. Ltr. Rul. 96-52-026, and Priv. Ltr. Rul. 97-25-036 during this period. For further discussion of these rulings and the issues they raise, see Frances R. Hill, *Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle*, 26 THE EXEMPT ORG. TAX REV. 205 (1999); Rosemary E. Fei, *The Uses of Section 527 Political Organizations*, in 1 STRUCTURING THE INQUIRY INTO ADVOCACY 23 (Elizabeth J. Reid, ed. 2000) available at <http://www.urgan.org/advocacyresearch/structuring.html>; Elizabeth Kingsley and John Pomeranz, *A Crash at the Crossroads: Tax and Campaign Finance Laws Collide in Regulation of Political Activities of Tax-Exempt Organizations*, 31 WM. MITCHELL L. REV. 55 (2005).

⁶⁵I.R.C. § 2522(a)(2).

⁶⁶After a controversy, the IRS announced in 2011 that it would not subject such transfers to gift taxation until further study. See Ellen Aprill, *Once and Future Taxation of Transfers to 501(c)(4) Organizations*, 15 NYU J. ON LEG. AND PUB. POL. 289 (2012).

527 political organizations are statutorily exempt from gift tax.⁶⁷ In the 1990's, a donor considering a large contribution to a politically-tinged lobbying effort would have preferred such endeavors to be structured as section 527 political campaign intervention. Traditional lobbying – acting to influence legislators or the public regarding legislation – is not, however, an exempt function under section 527. The shaping of such activities to qualify as exempt function activities is precisely what we see in these private letter rulings.

The election law motivation emerges from the limited jurisdiction of the FEC. At the time of these private letter rulings, an organization that engaged only in issue advocacy, that is, activity that stopped short of express advocacy,⁶⁸ could do so without triggering any requirement that it report to the FEC, disclosing the sources and uses of funds, or limiting the amount of funding received from particular individuals or entities. Neither, at the time, were such organizations subject to reporting or disclosure rules to the IRS under section 527 itself.⁶⁹ Thus, while political organizations regulated by the FEC were one category of organizations subject to section 527, organizations that engaged only in issue advocacy, such as some of those that sought and received these private letter rulings,⁷⁰ created a new category of entities subject to section 527 organizations, one free to raise large amounts of money for political campaign intervention,

⁶⁷I.R.C § 2501(a)(4). That both section 501(c)(3) organizations and section 527 organizations are explicitly free from gift tax under explicit provisions of the Internal Revenue Code, but section 501(c)(4) organizations are not strikes many as inconsistent. The House in April 2015 passed legislation, The Fair Treatment for All Gifts Act, H.R. 1104, exempting contributions to section 501(c) organizations from gift tax. See Kenneth P. Vogel & Hillary Flynn, *House Quietly Passes Tax Exemption for Megadonors*, POLITICO, Apr. 16, 2015, <http://www.politico.com/story/2015/04/house-quietly-passes-tax-cut-for-megadonors-117067.html>. A number of exempt organizations and exempt organization lawyers expressed support for the legislation. See *Organizations, Attorneys Support Exempt Org Deduction Bill*, 2015 TAX NOTES TODAY 72-30 (April 15, 2015).

⁶⁸The provisions about electioneering communications, communications close it time to an election or primary that name a candidate, that were at issue in *Citizens United v. FEC*, 558 U.S. 310 (2010), were enacted later, as part of the Bipartisan Campaign Reform Act of 2002.

⁶⁹*Id.*

⁷⁰The organization in Priv. Ltr. Rul. 19925051 stated that it planned as a minor part of its activities to make expenditures reportable under the Federal Election Campaign Act and parallel state campaign finance laws. It also anticipated such activities as convening planning sessions with candidates and responding to requests from candidates in some cases.

subject only to the income tax rules of section 527, and without disclosure or reporting obligations. These entities came to be known as section 527 organizations, while the political entities regulated by the FEC are known as political action committees (PACs), although PACs are also in fact subject to tax under section 527.

The favorable response of the IRS in these private letter rulings further encouraged such tax-only regulated section 527 organizations, and they soon were dubbed “stealth 527 organizations.” The growth of the tax-regulated section 527 organizations prompted Congress to make substantial changes to section 527 in 2000. As Richard Briffault has described, “Public concern with the use of section 527 to fund issue advocacy while avoiding disclosure of the identity of the donors sponsoring the issue ads came to a head in early 2000” with millions of dollars spent on issue advocacy by section 527 organizations.⁷¹ Within three months of their introduction, amendments to section 527 adding notification and disclosure requirements became law⁷² without formal legislative history.⁷³

Under these provisions, including amendments introduced in 2002,⁷⁴ an organization is not to be treated as an organization described in section 527 unless it gives electronic notice that it is to be so treated within 24 hours after the date on which it is established or not later than 30 days after any material change. Failure to give the required notice renders exempt function income

⁷¹Richard Briffault, *The 527 Problem . . . and the Buckley Problem*, 73 GEO. WASH. L. REV. 949, 959 (2005).

⁷²Act to Amend the Internal Revenue Code of 1986 to Require 527 Organizations to Disclose Their Political Activities, Publ. L. No. 106-230, 114 Stat. 477 (2000).

⁷³See Mayer, *The Much Maligned 527*, *supra*

⁷⁴The 2002 amendments provided that section 527 organizations engaged solely in state and local electoral activity that report and disclose their contributions and expenditures under a qualifying state law regime need not file with the IRS, required that the registration notice be filed electronically, required that reports of expenditures include the purpose of each expenditure, and required that the IRS make the registration notice and reports of expenditures and contributions available for public inspection on the Internet no later than 48 hours after such notice has been filed. Pub. L. No. 107-276, 116 Stat. 1929 (2002).

taxable.⁷⁵ This registration notice must include the names and addresses of the organization, its officers, directors, highly compensated employees, and related entities. Once registered, it must periodically file reports disclosing the names and addresses of contributors of \$200 or more per year and the amount, date and purpose of expenditures of \$500 or more per year.⁷⁶ Failure to make required disclosures in the time and manner described exposes the organization to a payment equal to the highest corporate tax rate multiplied by the amount to which the failure relates.⁷⁷ Section 527 organizations are also required to file Form 990.⁷⁸ The IRS and section 527 organizations must make these materials publicly available.⁷⁹

The disclosure requirements are strikingly similar to some of those imposed by FECA.⁸⁰ A House Committee Report on a similar but somewhat broader bill that did not become law acknowledged frankly, “Under the bill, the reporting periods and deadlines generally are the same as those required for reports under 2 U.S.C. 434(a) codifying the Federal Election Campaign Act of 1971 (FECA).”⁸¹ Statements in the Congressional Record leading up to the legislation identify it with campaign finance reform. Senator Reed asserted that section 527 organizations “exemplify the failure of our existing campaign finance laws” and “skirt existing campaign finance laws,” but predicted that mandated disclosure “will close yet another legal

⁷⁵ § 572(i)(1). Exempt function income is taxable until notice is given for a new organization or from the period of material change and until notice is given for a case of material change. § 527(i)(1)(B); (i)(4).

⁷⁶ § 527(j)(3).

⁷⁷ § 527(j)(1).

⁷⁸ I.R.C. § 6033(g).

⁷⁹ I.R.C. § 6104. Form 1120-POL, the income tax return of political organizations, was originally also to be made public, but Pub. L. No. 107-276, § 1931, 116 Stat. 1929 (2002) repealed that requirement.

⁸⁰ See Mayer, *The Much Maligned 527*, at 646 n.103 (comparing provisions).

⁸¹ H.R. REP. NO. 106-702 (2000). This bill would have imposed additional disclosure obligations on section 501(c) organizations engaged in political campaign intervention as well as on section 527 organizations. Contributors to section 501(c)(4), (5), and (6) organizations would have to be disclosed, unless the organization set up a segregated fund for earmarked contributions for political campaign intervention, in which case only contributors who earmark contributions would have been disclosed.

loophole.”⁸² Both Representative Castle and Senator Feingold described the legislation as “campaign finance reform.”⁸³ For Senator Lieberman, as for others, concerns about constitutionality also figured in shaping the legislation.⁸⁴ He asserted that *Buckley v. Valeo* permitted Congress to require disclosure by organizations whose major purpose is to elect candidates.⁸⁵ Important for our purposes, Senator Lieberman went on to say that the bill would be constitutional apart from *Buckley* on the basis of *Regan v. Taxation with Representation*,⁸⁶ because “any group not wanting to disclose information about itself or abide by the election laws would be able to continue doing whatever it is doing now – it would just have to do so without the public subsidy of tax exemption conferred by section 527.”⁸⁷ Nonetheless, he also described the debate and vote on the legislation as “the beginning of finally returning some limitation, some sanity, some disclosure, [and] some public confidence to our campaign finance laws.”⁸⁸

Whatever the motivation for or the Congressional understanding of section 527 and its amendments, it is a more recent enactment than section 501(c)(4). Any regulations regulating political campaign intervention by tax-exempt organizations must take into account the implications of section 527.

III. The Problematic Interaction of Sections 501(c) and 527

⁸²146 CONG. REC. S4921 (June 9, 2000) (statement of Sen. Reed).

⁸³146 CONG. REC. E 149 (June 29, 2000) (remarks of Rep. Castle); 146 CONG. REC. S5994 (June 28, 2000) (remarks of Sen. Feingold).

⁸⁴146 CONG. REC. S5996 (June 29, 2000) (statement of Sen. Lieberman).

⁸⁵*Id.*

⁸⁶*Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 544 (1983). *Regan* held that the subsidy of tax exemption permitted limitation on communications protected by the First Amendment, in this case, lobbying limits applicable to section 501(c)(3) organizations.

⁸⁷*Id.* The House Committee Report on the related bill, identified the exemption from the gift tax as a particular tax benefit conferred upon section 527 organizations and stated of *Regan*, “It is difficult to imagine that the Supreme Court would conclude that it is constitutional to eliminate a tax subsidy for certain activities, but not constitutional to require that organizations comply with reporting requirements with respect to those activities so that the IRS can monitor compliance with the law.” H.R. REP. NO. 106-702 (2000).

⁸⁸*Id.*

Section 527 operates to place a number of limits on Treasury and the Service in revising the 2013 Proposed Regulation. Section 527 complicates attempts both to define political campaign intervention⁸⁹ and to limit the amount of such activity to be permitted.

Sections 501(c) and 527, admittedly, define political campaign intervention for very different reasons – the former to narrow permitted activity and the latter to expand it. “Congress’s broad definition of section 527’s exempt function was intentional; its breadth was necessary in order to track and accommodate the wide range of income and activities that had previously been characterized as non-taxable by the Service and that the Service was then threatening to tax through administrative action.”⁹⁰ The 2013 Proposed Regulation borrows heavily from section 527’s definition of exempt function. By so doing, the 2013 Proposed Regulation accommodates those section 501(c)(4) organizations that are subject to section 527(f) tax.

In section 527, however, Congress regulated section 501(c)(4) activity under section 527(f) only to the extent that a section 501(c)(4) organization acted like a section 527 organization. The section 527(f) tax works to prevent a possible abuse of using untaxed money for political campaign intervention; the definition of exempt function under section 527 was not designed or intended to serve as the general definition of political campaign intervention for section 501(c) tax-exempt organizations. As the ABA Tax Section comments observe, “the application of section 527(f) to section 501(c) organizations is a statutory stop-gap to prevent section 501(c) organizations from conducting section 527 exempt function activities while

⁸⁹The 2013 Proposed Regulation’s borrowing from election law in defining candidate-related political activity is also a burden and a complication for exempt organizations. That complication, while requiring some discussion, is not the focus of this paper.

⁹⁰Comments of the ABA Section of Taxation, at 19.

avoiding the tax on section 527 organizations.”⁹¹ That is, the definition in section 527 is intended to give as wide a scope as possible for political campaign activities free of tax for political organizations. The definitions for section 501(c) organizations have the opposite purpose – to specify those activities that, in general, do not carry out exempt purpose. The statutory language itself makes it difficult to keep these distinctions straight – “exempt function” for purposes of section 527 is not coterminous with activities eligible for exemption under section 501(c)(3). Many activities that constitute exempt function under section 527 are limited for noncharitable section 501(c) organizations and forbidden for section 501(c)(3) organizations.⁹² Reconciling political campaign intervention under current law is fraught and difficult.

In response to the 2013 Proposed Regulation, comments from both left- and right-leaning organizations argued that political campaign intervention under section 501(c)(4) should be defined narrowly as including only “express advocacy” as established under federal election law.⁹³ The 2013 Proposed Regulation defines “candidate-related political activity” to include “express advocacy.” They define express advocacy as “any communication ... expressing a view on, whether for or against, the selection, nomination, election, or appointment of one or more clearly identified candidates or of candidates of a political party that” also “contains words that

⁹¹Comments of the ABA Section of Taxation, at 20.

⁹²To complicate matters even more, some activities that do constitute exempt function under section 527 are permitted even under section 501(c)(3), such as taking positions on judicial appointments. In Announcement 88-114, 1988-37 I.R.B. 26, the IRS proposed to characterize attempting to influence the confirmation of a federal judge, an activity in which a section 501(c)(3) organization can participate, as an exempt function activity for purposes of this provision and requested comments on this proposal. No final determination has been made. *See also* Gen. Couns. Mem. 39,694 (Jan. 21, 1988) (proposing that attempts to influence judicial and other executive branch appointments be taxable under section 527(f)).

⁹³*See* Comments of the Center for Competitive Politics, <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0011>; Comments of American Civil Liberties Union, <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-21490>. Express advocacy as established by the Supreme Court in *Buckley v. Valeo* is “communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office.” *Buckley v. Valeo*, 424 U.S. 1, 44 (1976). According to the FEC, express advocacy is a communication that when taken as a whole “could only be interpreted by a reasonable person as containing advocacy of the election or defeat of one or more clearly identified candidate.” 11 C.F.R. § 100.22(b).

expressly advocate, such as ‘vote,’ ‘oppose,’ ‘support,’ ‘elect,’ ‘defeat,’ or ‘reject;’ or is susceptible to no reasonable interpretation other than a call for or against the selection, nomination, election, or appointment of one or more candidates or of candidates of a political party.⁹⁴ As the earlier description of the 2013 Proposed Regulation makes clear, however, the 2013 Proposed Regulation does not limit the definition of candidate-related political activity to express advocacy.

In my view, section 527 constrains regulation under section 501(c)(4). It prevents limiting the definition of political campaign intervention for noncharitable tax exempt organizations to express advocacy. Section 527, as amended, requires registration with and disclosure of contributions and expenditures by organizations other than those section 501(c) organizations that engage in exempt function activity directly, those that are required to report under the Federal Election Campaign Act,⁹⁵ and certain state organizations.⁹⁶ As noted earlier, section 501(c) organizations that engage directly in exempt function activity are potentially subject to tax under section 527(f). To be subject to such tax, the noncharitable exempt organization would have to engage in exempt function activity not covered by the exemption for organizations that report to the FEC under FECA. Since express advocacy must be reported to the FEC, noncharitable exempt organizations would have to engage in political campaign activity that did not qualify as express advocacy in order to be taxed under section 527(f). That is, the structure of section 527, in particular the inclusion of the tax under section 527(f), demonstrates Congress’s intention that political campaign intervention within the meaning of section 527 “exempt function” reach more broadly than express advocacy and other activity

⁹⁴Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)((iii)(1), 78 Fed. Reg. at 71541 (Nov. 29, 2013).

⁹⁵§ 527(i)(6).

⁹⁶§ 527(i)(5)(C) and § 527(i)(5)(B) and (C).

subject to federal election law. Again, because of the operation of section 527, I believe that the definition of political campaign intervention for purposes of section 501(c)(4) must be broader than express advocacy. If political campaign intervention for noncharitable tax exempt organizations, including section 501(c)(4) organizations, is defined only as engaging in express advocacy, section 527(f) would be essentially superfluous.⁹⁷ The limited legislative history we have of the 2000 amendments makes clear, section 527 envisions that section 501(c) organizations will engage in political campaign intervention beyond express advocacy.

Admittedly, section 527 reaches broadly to include appointed office, and the 2013 Proposed Regulation adopts this definition.⁹⁸ The reliance in the 2013 Proposed Regulation on section 527 in defining “candidate,” and thus expanding the definition beyond elected to appointed offices as well as to those who have been proposed by others, marks an enormous change in IRS interpretation. This change is one that I believe errs in failing to take into account both the language and the particular purposes of section 527, as opposed to the purposes of section 501(c). As noted earlier, Congress, in enacting section 527, chose to codify existing IRS practice and to define political organization broadly in order to shield as many entities as possible from taxation. Under section 527(f)(2), for example, exempt function includes attempting to influence the selection of any “office in a political organization.” That is, section 527 uses the term “office,” not candidate.

⁹⁷Thus, the Taxpayer Advocate’s suggestion that legislation “authorize the IRS to rely on a determination of political activity from the Federal Election Commission (FEC) or other programmatic agency,” National Taxpayer Advocate, Special Report to Congress, *supra* note at 16, would limit political campaign intervention to a band far narrower than Congress intended when it enacted section 527, even if, as I have written, the amendments to section 527 are campaign finance laws in tax clothing. Aprill, *Regulating the Political Speech of Nonprofit Noncharitable Exempt Organizations after Citizens United*, at XX. So long as entities exempt from taxation can engage in political campaign intervention, Treasury and the IRS will need to be involved in defining such activity.

⁹⁸Prop. Treas. Reg. § 1.501(c)(4)-1(q)(iii)(B)(1), 78 Fed. Reg. at 71541.

For noncharitable section 501(c) organizations, the limits on political campaign intervention have applied only to elected public office. The IRS has not placed appointed office within the category of intervention in a political campaign, because it has based the definition of political campaign intervention applicable to all section 501(c) organizations on the language of section 501(c)(3),⁹⁹ and section 501(c)(3) speaks of intervention in any political campaign of “any candidate for public office.” We do not usually consider those seeking or receiving appointed office as “candidates.” Treas. Reg. § 1.501(c)(3)-(1)(c)(iii) and Treas. Reg. § 53.4945-(3)(a)(2) interpret candidate for public office as “a contestant for an elective public office.” Congress enacted section 4955, the provision applying an excise tax on campaign intervention activities of section 501(c)(3), in 1987, more recently than section 527, and its definition of political campaign intervention carries particular weight.¹⁰⁰ Section 4955 defines political campaign intervention, which it dubs “political expenditure,” in the same way as section 501(c)(3).¹⁰¹ Similarly, section 501(c)(29), enacted in 2010 as part of the Affordable Care Act, defines a tax-exempt health insurance carrier using the same language as section 501(c)(3) regarding political campaign intervention.¹⁰²

As a number of comments on the Proposed Regulation observed, as a practical matter, the impact of definition of political campaign intervention for an exempt organization depends on

⁹⁹Revenue Ruling 67-368, for example, held that comparative rating of candidates, even on a nonpartisan basis, is participation or intervention on behalf of candidates favorably rated and in opposition to those less favorably rated and thus cannot be the primary activity of a section 501(c)(4) organization. Revenue Ruling 81-95 held that a section 501(c)(4) organization primarily engaged in activities that promote social welfare may also carry on lawful political campaign intervention. For examples of what constitutes political campaign intervention, Revenue Ruling 81-95 cited not only Revenue Ruling 67-368, but also a number of revenue rulings involving section 501(c)(3) organizations.

¹⁰⁰See ABA Tax Section Comments, *supra*, at 21-22.

¹⁰¹“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 in opposition to) any candidate for public office.” Section 4955(d)(1). The definition also explicitly includes some additional expenses such as conducting polls, surveys, and expenses of advertising, publicity and fundraising. I.R.C. § 4955(d)(2) (1996).

¹⁰²P.L. 111-148.

the amount of such activity permitted. That is, those affected cannot evaluate fully any proposed regulation unless the proposal specifies the amount of political campaign intervention that would be permitted.¹⁰³ An expansive definition of political campaign intervention has far less of an impact on section 501(c) organizations if a large amount of such activity is permitted; if no or little of such activity is permitted, then a broad definition sharply constrains the activity of these entities.

Some comments on the Proposed Regulation, most eloquently by those of Rep. Van Hollen/Democracy 21/Campaign Legal Center, have argued that the applicable statutory language requiring that section 501(c)(4) entities be “operated exclusively for the promotion of social welfare” means that they can engage in no political campaign intervention whatsoever,¹⁰⁴ despite the absence of an explicit prohibition, such as that found in section 501(c)(3). This conclusion relies on two propositions, first, that political campaign intervention does not promote social welfare (a position that is consistent with the current regulation), and second, the position that the current regulation exceeds statutory authority when it reinterprets “exclusively” as “primarily.”¹⁰⁵

As to the first position, other comments on the Proposed Regulation question the assumption that political campaign activity fails to promote social welfare. Although the Proposed Regulation would consider nonpartisan activities as candidate-related political activity, according to the Alliance for Justice, for example, “it cannot be denied that promoting civic

¹⁰³ABA Tax Section comments, *supra*, at 3-4; Comments of Rep. Van Hollen/Democracy 21/Campaign Legal Center, <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-126088>.

¹⁰⁴Comments of Rep. Van Hollen et al., <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-126088>. The discussion that follows is intended to address as well a variation of this position, that such organizations be allowed to engage in a de minimis amount of political campaign literature.

¹⁰⁵Professor Miriam Galston argued for relying on the statutory language in a June 4, 2015 Washington Post editorial, *The IRS's Chief's Mistake about Dark Money*, http://www.washingtonpost.com/opinions/the-irs-chiefs-mistake-about-dark-money/2015/06/04/0f4a22ae-095e-11e5-9e39-0db921c47b93_story.html.

participation and engagement by citizens, improving democracy by educating voters, and educating candidates about the needs of the community all promote the common good and general welfare of the community.”¹⁰⁶

For me, the best argument that promotion of social welfare should not include political campaign activity for the purposes of tax law has been made in connection with the prohibition of such activities by charities, both in this country and elsewhere. For example, a 2008 Pamphlet from the Charities Commission of England and Wales explains,¹⁰⁷

A charity cannot give general support to a political party, because all political parties have a range of policies. So if a charity endorses a party because it agrees with one policy (say on climate change), it is effectively supporting the party as a whole and will be endorsing the party’s wider policies (say on taxation, education, defense [sic] etc) which are nothing to do with the charity’s purposes.

Similarly, a section 501(c)(4) organization must act in accordance with its exempt purpose. Thus, such organizations may lobby without limit, so long as the lobbying is related to their exempt purpose.¹⁰⁸ Engaging in political campaign intervention will inevitably involve issues not related to such organizations’ exempt purposes. Terence Dougherty and Lloyd Mayer make another compelling point to reach a similar conclusion. They argue that political campaign intervention does not constitute social welfare because such activities involve impermissible private benefit.¹⁰⁹

¹⁰⁶Comments of Nan Aaron, *Alliance for Justice*, at p.2, <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-124817>.

¹⁰⁷CHARITY COMMISSION, SPEAKING OUT: GUIDANCE ON CAMPAIGNING AND POLITICAL ACTIVITY BY CHARITIES (CC9), 2008 (U.K.), <http://www.charitycommission.gov.uk/media/94387/cc9text.pdf>.

¹⁰⁸Rev. Rul. 71-350. “Organizations described in IRC 501(c)(4), (c)(5), and (c)(6) may engage in an unlimited amount of lobbying, provided that the lobbying is related to the organization’s exempt purpose.” 2003 EO CPE Text, John Francis Reilly and Barbara A. Braig Allen, *Political Campaign and Lobbying Activities of IRC 501(c)(4), (c)(5) and (c)(6) Organizations*, EXEMPT ORGANIZATIONS TECHNICAL INSTRUCTIONS PROGRAM FOR FY 2003, p. L-2, available at <http://www.irs.gov/pub/irs-tege/eotopicl03.pdf>.

¹⁰⁹ Terence Dougherty, *Section 501(c)(4) Advocacy Organizations: Political Candidate-Related and Other Partisan Activities in Furtherance of the Social Welfare*, 36 SEATTLE U. L. REV. 1337, 1393-1400 (2013); Lloyd Hitoshi Mayer, *Disclosure about Disclosure*, 44 IND. L. REV. 255 (2010); Lloyd Hitoshi Mayer, *Regulating Politics, Taxing Politics* (available from author).

As for the argument about “exclusively” in the statutory language, as I have argued elsewhere,¹¹⁰ the IRS and Treasury did not contradict, but carried out Congressional intent in reinterpreting “exclusively” as “primarily.” This regulatory reinterpretation was needed after 1950, when Congress enacted a set of rules known as the unrelated business income tax, or the UBIT. Pre-UBIT, tax exemption depended on the destination, not the source of the income. Famously, the New York University owned Mueller Macaroni, which operated free of tax because its profits supported the school’s exempt activities. Spurred by such concerns over unfair competition and lost revenue, Congress enacted the UBIT. The UBIT taxed any trade or business regularly carried on by section 501(c) organizations if the activity is not related—aside from the need for funding—to the organization’s exempt purpose.

The UBIT rules acknowledged and accepted that exempt organizations could engage in activities that did not carry out their exempt purpose. Thus, the earlier statutory language requiring that section 501(c)(3) and section 501(c)(4) organizations operate “exclusively” for their exempt purposes no longer accurately described the applicable law. Treasury regulations then reinterpreted “exclusively” as “primarily” for both section 501(c)(3) and section 501(c)(4).¹¹¹

In the case of section 501(c)(4) organizations, the applicable regulation specified that the “promotion of social welfare does not include direct or indirect participation or intervention in

¹¹⁰Ellen P. Aprill, *The IRS’s Tea Party Tax Row: How ‘Exclusively’ Became ‘Primarily,’* PAC. STANDARD (June 7, 2013, 8:00 AM), <http://www.psmag.com/politics/the-irss-tea-party-tax-row-how-exclusively-became-primarily-59451>. The following paragraphs are based on this op-ed. Roger Colinvaux, *Political Activity and Tax Exemption: A Gordian Knot*, 34 VA. TAX REV. 1, 29-33 (2014), makes a similar argument with a similar conclusion. As he notes, one former Treasury official, reflecting on these regulations, has written that “Treasury determined that it could not legally support the position that an organization could lose its exempt status as a result of substantial unrelated business activity.” *Id.* at 30-31, n.130, *quoting* Thomas A. Troyer, *Quantity of Unrelated Business Consistent with Charitable Exemption—Some Clarification*, 56 TAX NOTES 1075 (August 24, 1992). See also STAFF OF J. COMM. ON TAXATION, 109TH CONG., HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS, at 49 n. 70 (Joint Comm. Print 2005).

¹¹¹Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

political campaigns on behalf of or in opposition to any candidate for public office.”¹¹² This IRS regulation, although not issued until 1959, specified that it applied retroactively to 1953.¹¹³ The proposed section 501(c)(4) regulation issued in 1956 made no reference to political campaign intervention;¹¹⁴ discussion of political campaign intervention by section 501(c)(4) organizations came only after further consideration. The set of 1956 proposed regulations, however, did include an elaborate set of proposed UBIT regulations.¹¹⁵ Like the regulations as adopted, the 1956 proposed section 501(c)(4) regulations used “primarily” rather than “exclusively,”¹¹⁶ and offer further evidence of the connection between UBIT and the administrative interpretation of “exclusively” as “primarily.”

Critics of the “primarily” language in the regulations often point to language in a 1945 Supreme Court opinion, *Better Business Bureau*,¹¹⁷ that the presence of any substantial non-exempt purpose will destroy exemption. “Purpose,” however, is not the same as “activity,” and the 1959 section 501(c)(3) and section 501(c)(4) regulation focuses on the nature of the exempt organization’s operations and activities, not their purpose. Moreover, *Better Business Bureau*

¹¹²Prop. Treas. Reg. § 1.501(c)(40-1(2)(ii), 24 Fed. Reg. 1421, 1423 (Feb. 26, 1959).

¹¹³T.D. 6391, 24 Fed. Reg. 5217 (June 26, 1959).

¹¹⁴See Prop. Treas. Reg. § 1.501(c)(4)-1, 21 Fed. Reg. 460, 465 (Jan. 21, 1956). These proposed regulations were withdrawn when revised regulations were proposed in 1959. 24 Fed. Reg. 1421, 1421 (Feb. 26, 1959).

¹¹⁵21 Fed. Reg. 460, 470-78 (Jan. 21, 1956).

¹¹⁶*Id.* at 465.

¹¹⁷*Better Business Bureau v. U.S.*, 326 U.S. 279 (1945). Appellate courts, however, applied *Better Business Bureau* to section 501(c)(4) organizations. See, e.g., *Vision Serv. Plan v. United States*, 265 Fed. Appx. 650, 651 (9th Cir. Cal. 2008); *American Association of Christian Schools Voluntary Employees Beneficiary Ass’n Welfare Plan Trust v. United States*, 850 F.2d 1510, 1515-16 (11th Cir. 1988); *Police Benevolent Ass’n of Richmond, Va. v. United States*, 661 F. Supp. 765, 773 (E.D. Va. 1987), *aff’d without opinion*, 836 F.2d 547 (4th Cir. 1987); *Mutual Aid Association of the Church of the Brethren v. United States*, 7559 F.2d 792, 796 (10th Cir. 1985); *Contracting Plumbers Cooperative Restoration Corp. v. United States*, 488 F.2d 684, 686 (2d Cir. 1973), *cert. denied*, 419 U.S. 827 (1974).

predated the UBIT regime and thus could not consider the impact of unrelated activities on exemption.¹¹⁸

But more important for purposes of this paper, regulations for section 501(c) social welfare and other noncharitable exempt organizations that prohibit them from engaging in any political campaign intervention would be inconsistent with section 527, a provision enacted long after section 501(c)(4) and the UBIT provisions. Section 527(f)(3) specifically authorizes a section 501(c) organization to set up a separate segregated fund treated as a political organization under section 527 to engage in exempt functions free of tax.¹¹⁹ That is, the statute anticipates use of section 501(c) monies for such activity.

Furthermore, as discussed above, section 527(f) permits a section 501(c) organization to engage directly in section 527 exempt function activity – which includes, but is broader, than the traditional section 501(c) definition of political campaign intervention – so long as the organization pays tax on the lesser of the amount spent for such activity or net investment income, if any. That is, in enacting section 527, members of Congress, whether they knew of the applicable section 501(c)(4) regulation or not, assumed that political campaign intervention was permitted to section 501(c) organizations.

The Campaign Legal Center argues that taxing this activity does not mean that it is a permitted activity. “That such activity is taxable does not mean that it is permissible at all.”¹²⁰ Such reasoning seems to me inconsistent with the purpose and legislative history of section 527.

¹¹⁸In retrospect, we might wish that the 1959 regulations had permitted only unrelated activity subject to the unrelated business income tax, on the basis that, while the activity itself may be related to exempt purpose, unrelated business activities are intended to raise funds for exempt purposes. They did not, however, do so. Moreover, they were not silent about section 501(c)(4) political campaign intervention. They considered this issue and addressed it.

¹¹⁹Treas. Reg. § 1.527-6(e) (1980).

¹²⁰Comments of Van Hollen et al., *supra*, at page 9.

The section 527(f) tax is intended to ensure that all money spent on political campaign intervention is taxed at least once, simply as a means to ensure a level playing field.¹²¹ It is not a sanction.

In that regard, section 527(f) stands in sharp contrast to the tax under section 4955, which is an excise tax imposed on section 501(c)(3) organizations as a sanction for violating the prohibition on political campaign intervention. As the IRS has explained, “Congress viewed the IRC 4955 taxes. . . . primarily as an additional tax and, secondarily as a sanction to apply instead of revocation in certain limited situations. . . . The 1987 enactments were intended to strengthen . . . the prohibition on political campaign activity.”¹²² Section 4955 regulations specify that the excise taxes imposed by the provision do not affect the standards for exemptions under section 501(c)(3).¹²³ Section 4955 and its legislative history does not support a reading of section 527(f) that narrowly limits the amount of political campaign intervention permitted to section 501(c)(4) organizations.

Furthermore, prohibiting or sharply limiting the amount of political campaign intervention permitted to section 501(c) organizations would leave an enormous gap in the Code. Section 527 applies to political organizations, which under section 527(e)(1) must be “organized and operated primarily” for “accepting contributions or making expenditures, or both, for an exempt function.” If noncharitable exempt organizations are forbidden from political campaign intervention or allowed only a de minimis amount, say 10-15% of activity, then organizations that engage in such activity above that ceiling, but less than primarily would exist in a tax limbo, are no longer tax-exempt section 501(c) entities but not eligible for section 527 treatment. They

¹²¹See text *supra* at notes

¹²²Judith E. Kindell and John Francis Riley, Election Year Issues, 2002 EO CPE Text, pp. 353-54, *available at* <http://www.irs.gov/pub/irs-tege/eotopici02.pdf>.

¹²³Treas. Reg. § 53.4955-1(a) (1995).

would probably be categorized as taxable entities,¹²⁴ but without certainty to how contributions and expenditures would be characterized and without public filing of annual information returns. As Professors Galle and Tobin observed in their comments on the 2013 Proposed Regulation, “Without further clarification by the IRS, taxable organizations may be the next vehicle of choice to avoid campaign finance disclosure, and may once again embroil the IRS in unnecessary political decisions.”¹²⁵

Thus, any significant reduction in the amount of political campaign intervention is problematic not only because of the current structure of the Internal Revenue Code, but also as a practical matter. In part out of concern for this gap,¹²⁶ the comments of the ABA Tax Section comments on the Proposed Regulation assume a 40% limit.¹²⁷ The Comments explain that a 40% limit by monetary expenditure “include relative ease of computation and administration, while at the same time ensuring social welfare purposes and activities remain materially above one-half of total activities.”¹²⁸ The ABA Tax Section Comments reject a 49% limit on the grounds that a 49% limit “requires a level of precision that is difficult to administer, allows no room for error by the organization or the Service, and may encourage abusive uses of section 501(c)(4) exempt

¹²⁴See Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They the Next “Loophole”?* 6 FIRST AMEND. L. REVIEW 41 (1997); Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 GA. L. REV. 611 (2003).

¹²⁵Galle and Tobin Comments, *supra* at 19. Mayer, *Regulating Politics, Taxing Politics*, *supra*, does not find such a gap disturbing, because he views political contributions not as income and political activity expenses not deductible under general tax principles.

¹²⁶The ABA Tax Section comments describe as a concern “the absence of any tax-exempt status for an organization all of whose activities would be exempt under either section 501(c)(4) or section 527, except that it engages in more than the permitted amount of political intervention under section 501(c)(4), but less than substantially all political intervention as required by section 527. This gap will be larger the lower the limit on political intervention by 501(c) organizations is set.” ABA Section of Taxation, *supra*, at 7-8.

¹²⁷*Id.* As the ABA comments explain the IRS used a 40% limit for expedited review of backlogged Form 1024 applications for exemption under section 501(c)(4) and a 2004 ABA Tax Force suggested a 40% limit, although the two principal authors of the 2004 Report have more recently endorsed limits lower than 40%. *Id.* at 6, fn 35.

¹²⁸*Id.*

status.”¹²⁹ The ABA also recommended that “the minimum level of political intervention required for section 527 exemption be adjusted to approach or mirror the maximum under section 501(c)(4): we see no public policy justification for withholding tax-exempt status from nonprofit organizations that fall in the gap.”¹³⁰

While I personally would prefer a limit for political campaign intervention by noncharitable section 501(c) organizations well below 40%, I find a low limit difficult to justify under current law. Treasury and the IRS could, by regulation, deem 40% by money expenditure to be a safe harbor, as happened with expedited review of applications for exemption under section 501(c)(4),¹³¹ but I see a significant risk, even with the deference given to Treasury regulations,¹³² of a 40% maximum by money expenditure would be sustained upon challenge.¹³³

Section 527, therefore, poses a number of dilemmas for those drafting regulations regarding political campaign intervention by section 501(c) organizations. My own concern for abusive uses of section 501(c) exempt status and belief in the benefits of disclosure of contributors beyond those required currently under FEC lead me to call for fundamental changes to section 527 and to section 501(c),¹³⁴ as explained below.

¹²⁹*Id.* at 7.

¹³⁰*Id.* at 8.

¹³¹Add cross-reference

¹³²*See* Mayo Found. For Med. Ed. & Res. v. United States, 562 U.S. 44 (2011).

¹³³Galle and Tobin, *supra*, at p.10 recommend capping section 501(c)(4) political campaign expenses at some amount lower than \$1 million. They would have the IRS and Treasury interpret the “primarily” language defining a political organization under section 527(e)(1) to mean “substantially” and define “substantially” to be 10% of a section 527 organization’s budget or no more than an overall cap, such as \$1 million. *Id.* at 3. Arguably, new regulations under section 527 reinterpreting “primarily” as “substantially” parallel the current section 501(c)(4) regulations interpreting “exclusively.” However, I do not see the same justification for such a change as introduction of the UBIT offered for the section 501(c)(4) regulation and thus believe legislative change is needed to achieve such a result, however sympathetic I am to the structure Galle and Tobin endorse.

¹³⁴Justifications for disclosure are discussed below in connection with *Citizens United v. FEC*, 558 U.S. 310 (2010), and for purposes of this piece, I accept the Court’s arguments in that case and do not make an independent argument regarding the costs and benefits of disclosure. *See generally* Lloyd Hitoshi Mayer, *Disclosure about Disclosure*, 44 IND. L. REV. 255 (2010); Lloyd Hitoshi Mayer, *Regulating Politics, Taxing Politics* (available from author).

IV. *Recommendations for Change*

The world today regarding political campaign intervention differs substantially not only from the 1970's, when section 527 was enacted, but even from 2000, when it was amended. The prominence of section 501(c) organizations in political campaign intervention also reflects this changed world. In 2006, section 501(c)(4) organizations spent \$1.3 million on political spending, and by the 2012 election that number ballooned to \$256 million.¹³⁵ According to the Center for Responsive Politics as of May 6, 2015, spending by tax exempt organizations not required to disclose donors totaled more than \$300 million in the 2012 election and more than \$174 million in the 2014 midterm elections.¹³⁶

As discussed above, the legislative history of the amendments to section 527 indicates that Congress saw it as campaign finance reform, but believed it needed tax exemption and thus a place in the Internal Revenue Code as a constitutional hook for requiring disclosure. *Citizens United* strongly suggests that such is no longer the case.¹³⁷ Campaign finance reform represented by the amendments to section 527, in particular the disclosure of contributions and expenditures for political campaign intervention, no longer should, but also clearly can, be moved out of the IRS and to the FEC.

In *Citizens United*, all of the Justices except Justice Thomas upheld disclaimer and disclosure requirements required of Citizens United under election law.¹³⁸ Such requirements, Justice Kennedy wrote, while they burden the ability to speak, “impose no ceiling on campaign-

¹³⁵Comments of Sheila Krumholz, Center for Responsive Politics (Feb. 27, 2014), *available at* <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-115413>

¹³⁶Center for Responsive Politics, *Political Nonprofits (Dark Money)*, https://www.opensecrets.org/outsidespending/nonprof_summ.php.

¹³⁷*Citizens United v. FEC*, 558 U.S. 310 (2010).

¹³⁸*Id.* at 366.

related activities.”¹³⁹ Thus, they “are subject to exacting scrutiny,” which requires a “substantial relation between them and a sufficiently important government interest.”¹⁴⁰ Justice Kennedy found that the same interest that sustained facial challenges to such provisions, namely helping citizens to “make informed choices in the political marketplace,” applied here.¹⁴¹ Moreover, because “disclosure is a less restrictive alternative to more comprehensive regulations of speech,” disclosure requirements need not be limited to speech that is the functional equivalent of express advocacy.¹⁴²

Citizens United argued that disclosure requirements can chill donations to an organization by exposing donors to retaliation, but the Court concluded that the organization had not made a showing of harassment or retaliation in its case. In fact, the “First Amendment protects political speech; and disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and to give proper weight to different speakers and messages.”¹⁴³

Under this reasoning, the disclosure currently required could be moved from the IRS to the FEC.¹⁴⁴ I believe Congress could and should do so. As Lloyd Mayer has recently discussed, consideration of relevant effectiveness, on the one hand, and the risk of collateral reputational harm to an agency as a result of regulating disclosure in connection with political campaign

¹³⁹*Id.* quoting *McConnell*, 540 U.S. at 291.

¹⁴⁰*Id.* quoting *Buckley* at 64.

¹⁴¹*Id.* at 369.

¹⁴²*Id.*

¹⁴³*Id.* at 371.

¹⁴⁴As noted earlier, Lloyd Mayer has made an argument for such a move based on greater institutional competence by the FEC. See Mayer, *The Much Maligned 527*, *supra*. At the time he wrote his article, *Citizens United* had not been decided. He more recently reached the same conclusion under a slightly different framework. Mayer, *Regulating Politics*, *supra*. As he credits, Prof. Lily Kahng emphasized the risk to the IRS as a whole and its role as revenue collector as a result of the reputational harm suffered because of its treatment of section 501(c)(4) organizations in Lily Kahng, *The IRS Tea Party Controversy and Administrative Discretion*, 42 CORNELL L. REV. ONLINE 41, 51-52 (2013).

intervention, on the other, favors assigning responsibility for disclosure to the FEC.¹⁴⁵ Despite the deadlocking that the FEC has experienced in regulating, including in connection with regulation of disclosure, given its current structure of three commissioners appointed by each of the two major political parties,¹⁴⁶ its expertise includes, at its core, disclosure about political campaign intervention as such intervention occurs. Any failures or successes in this regard involve its core activities. The FEC also has more resources than the IRS to enforce disclosure.¹⁴⁷ Prof. Colinvaux also endorses moving responsibility for disclosure from the IRS to the FEC.¹⁴⁸

Nonetheless, like Congress at the time of the section 527 amendments, I believe that a definition of political campaign intervention broader than that permitted by the FEC is necessary for citizens to enjoy the benefits of disclosure in the course of political campaigns. Thus, I would retain a broad definition of exempt function for purposes of section 527. (Even if disclosure in connection with section 527 organizations were moved to the FEC, a definition would need to remain in the Internal Revenue Code in order to specify the tax treatment of these organizations.)

Also as noted above, at the time of the enactment of the amendments to section 527, Congress expected section 501(c) organizations to choose to operate through separate segregated funds. As we now know well, Congress was wrong in its assumptions. Congress, however, should correct its error by requiring all campaign intervention to take place through section 527 organizations and requiring disclosure of contributions to and expenditures from them, the disclosure regime to be under the aegis of the FEC.

¹⁴⁵Mayer, *Regulating Politics*, at 18. If new laws giving the FEC such power are not feasible, however, Mayer would look to the IRS because “a poor tool is better than no tool at all.” *Id.*

¹⁴⁶Mayer, *Regulating Politics* at 15.

¹⁴⁷*Id.* at 16-17.

¹⁴⁸Colinvaux, *Gordian Knot*, *supra* at 6, 48.

That is, I would require all political campaign intervention to be conducted through section 527 organizations, which, recall, need be no more than a bank account.¹⁴⁹ Under this regime, neither for-profit nor exempt organizations could engage directly in political campaign intervention, under the broad definition of exempt function provided in section 527. Section 527(f) would be repealed, although tax on investment income would be retained. With such changes to section 527, it would be possible to require, either through legislation or regulation, that exempt organizations engage in no political campaign intervention or only an insubstantial amount of such activity. I do not think that such limits are possible under current law.¹⁵⁰ With these changes, it might also be appropriate to introduce some kind of excise tax as a sanction short of revocation in appropriate circumstances for violation of the prohibition.¹⁵¹

At the same time that I recommend limiting the permissible activities for noncharitable section 501(c) organizations. I would, as have a number of others, urge that the permissible activities of section 527 organizations be broadened. Thus, like Professors Galle and Tobin, I would redefine section 527 so that it encompasses any organization that engages substantially in political campaign intervention, although, as noted earlier, I believe legislation is needed for such a change.¹⁵² Professor Colinvaux also suggests expanding tax exemption for political organizations “to include income from noncharitable exempt purposes (in particular for social

¹⁴⁹I note that Prof. Colinvaux suggests as one possibility, the opposite approach—that limits on the political activity of noncharitable exempt organizations be eliminated. Colinvaux, *Gordian Knot*, *supra* at 49-50.

¹⁵⁰If noncharitable section 501(c) organizations could engage in an insubstantial amount of political campaign intervention, they could transfer funds from their treasuries to related section 527 organizations.

¹⁵¹This suggestion very closely resembles that of Professor Mayer, although he prefers an insubstantial part rule because “the penalty of loss of tax exemption status is relatively draconian and so should not be triggered by an insubstantial level of activity.” Mayer, *Regulating Politics*, at 40. An excise tax on insubstantial political campaign intervention, however, would avoid loss of exemption without the need for having an insubstantial part rules.

¹⁵²Cross reference to earlier discussion in fn.

welfare, labor, and trade association purposes).”¹⁵³ The comments of the Bright Lines Project also suggest that section 527 “be amended to fit within the system by providing a tax-exempt home for ANY organization that fails to qualify under a section 501(c) category due to excessive political activity, even if that activity is less than primary.”¹⁵⁴ In my view, any contribution to or expenditure by a section 527 organization, whether or not for political campaign intervention, should, however, require disclosure.

The amendments suggested above would achieve disclosure and channel political campaign intervention more simply than the DISCLOSE Act of 2015.¹⁵⁵ Any substantial campaign intervention would take place only through a section 527 organization. Thus, there would no longer be any need for the provisions under DISCLOSE that section 501(c) organizations either report contributions that could be used for campaign intervention or undertake the heavy burden of prohibiting, in writing, use of disbursements for political campaign intervention.¹⁵⁶

In short, the failure of congruence between section 527 and other provisions of the Internal Revenue Code as well as the impact of *Citizens United*, both as a practical matter and in connection with the justifications for enacting the 2000 amendments to section 527, call for Congress to amend section 527 with amendments that will make possible for Treasury and the

¹⁵³Colinvaux, *Gordian Knot*, *supra* at 50. He continues, “This would have the effect of eliminating the sanction for breach of the political activity limits by a noncharitable exempt. . . . The 527(f) tax would be replaced in effect with a tax on investment income.” *Id.*

¹⁵⁴Bright Lines Project, *supra*, at 18. The Bright Lines Project suggests that the section 527 regulations also be re-drafted “to adopt the same standards as applies to 501(c)s.” *Id.* at 19. It makes a number of other specific suggestions, more detailed than the discussion in this article, regarding section 527 and regulations under section 527, both in its comments and on its webpage. See *The Bright Lines Project: Clarifying IRS Rules on Political Intervention* (May 8., 2014), <http://www.brightlinesproject.org/wp-content/uploads/2015/06/May-8-Explanation-with-Exhibit.pdf> at 9-10. For example, BLP recommends “continuing the exemption of internal member communications and indirect fundraising and administrative costs, currently tax-free for 501(c) groups under the 527 regulations.” *Id.* at 10.

¹⁵⁵Cross-reference to earlier cite to DISCLOSE Act

¹⁵⁶DISCLOSE Act, Section (b).

IRS to promulgate meaningful regulations regarding political campaign intervention by noncharitable exempt organizations.

V. *Conclusion*

As the race for the 2016 Presidential campaign gets underway, the need grows for guidance on what political campaign intervention is permitted under the Internal Revenue Code for noncharitable tax exempt organizations. The importance to the electorate about who is funding political campaign intervention grows as well. The first attempt by Treasury and the IRS to offer at least some guidance, the 2013 Proposed Regulation, failed. While a new version will likely improve on the 2013 Proposed Regulation, without changes to the applicable statutory provisions, tax administrators will face severe limits on the guidance they can offer. Perhaps, however, a brief opportunity will exist shortly after the 2016 election, if the new President, the Congress, the press, and the public reflect on the financial costs and the cost to our democracy of the current interaction between our tax and campaign finance laws.