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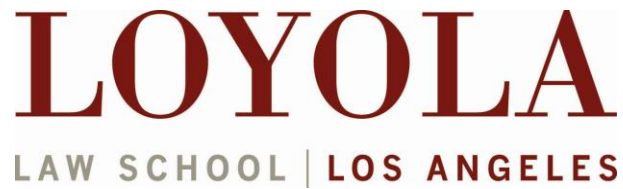
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# Why the IRS Should Want to Develop Rules Regarding Charities and Politics

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## Why the IRS Should Want to Develop Rules Regarding Charities and Politics

Ellen P. Aprill\*

At All Saints Episcopal Church in California, two days before the 2004 presidential election, its former pastor imagined a debate between Jesus and the presidential candidates. The pastor began by assuring his listeners, "I don't intend to tell you how to vote."<sup>1</sup> He went on, in the voice of Jesus, to criticize the Iraq war into which "President Bush has led us," wondered whether President Bush really meant "to end a decade-old ban on developing nuclear battlefield weapons," asked why so little was mentioned about the poor, and asserted in his own voice that the number of abortions had risen under George W. Bush because women having abortions could not afford to have a child.<sup>2</sup> The pastor concluded "When you go into the voting booth on Tuesday, take with you all that you know about Jesus, the peacemaker. Take all that Jesus means to you. Then vote your deepest values."<sup>3</sup>

A few months earlier, on July 11, 2004, Julian Bond spoke at the 2004 NAACP Convention. His lengthy speech reviewed the civil rights records of presidents of both parties, but especially criticized the Republican party, its tax policy, civil rights policy, the war in Iraq, and other foreign and domestic policy issues.<sup>4</sup> Bond continued "The election this fall is a contest between two widely disparate views of who we are and what we believe. One view wants to march us backward through history – surrendering control of government to special interests, weakening democracy, giving religion veto power over science, curtailing civil liberties, despoiling the environment. The other view promises expanded democracy and giving the people, not plutocrats, control over their government."<sup>5</sup> The speech included statistics about

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<sup>1</sup> [http://www.allsaints-pas.org/pdf/\(10-31-04\)%20If%20Jesus%20Debated.pdf](http://www.allsaints-pas.org/pdf/(10-31-04)%20If%20Jesus%20Debated.pdf). The sermon criticized Senator Kerry by name as well, but not to the extent that it took President Bush to task.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> <http://moritzlaw.osu.edu/electionlaw/docs/church/naacp-speech.pdf>

<sup>5</sup> *Id.*

African American voter registration drives and voting records. It urged the audience to vote in the upcoming election.

As a result of these communications, the Internal Revenue Service (“IRS” or “Service”) investigated both of these organizations, which are tax-exempt under section 501(c)(3), because such entities cannot, at risk of loss of exemption, “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.”<sup>6</sup> That is, they are subject to a campaign intervention prohibition. Such organizations, commonly referred to as charities, therefore cannot endorse or oppose a candidate for public office or contribute to the candidate’s campaign. The IRS has long interpreted this campaign intervention prohibition broadly. An applicable regulation, for example, refers to violating the prohibition “directly or indirectly.”<sup>7</sup>

Revenue Ruling 2007-41, the most recent and comprehensive official IRS pronouncement on the subject, explains that “[w]hether an organization is participating or intervening, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office depends upon all of the facts and circumstances of each case.”<sup>8</sup> Applying the facts and circumstances test, the IRS determined that All Saints Episcopal Church violated the campaign intervention prohibition, but that the NAACP did not.<sup>9</sup>

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<sup>6</sup> Section 501(c)(3). All references are to the Internal Revenue Code of 1986, as amended, unless other specified.

<sup>7</sup> See Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iii) (an organization is an action organization not eligible for section 501(c)(3) status if it violates the campaign intervention prohibition “directly or indirectly”).

<sup>8</sup> Revenue Ruling 2007-41, 2007-1 C.B. 1421. Issuance of the revenue ruling followed issuance of an IRS fact sheet which included similar but not identical examples, but which did not represent official guidance or advice of the National IRS office and thus was not a document on which taxpayers could rely as authority. See *IRS Issues Guidance on Charities and Politics as Election Year Looms*, 2007 TNT 111-4 (June 8, 2007) (comments of exempt organization specialists comparing fact sheet to revenue ruling). For a discussion of revenue rulings, notices, and their degrees of relative authority, see Kristin E. Hickman, *IRB Guidance: The No Man’s Land of Tax Code Interpretation*, 2009 MICH. ST. L. REV. 239, 243, 2494; section 6110 (definition of authority). See also IRS, *Internal Revenue Code, Treasury (Tax) Regulations, Other Official Guidance*, available at <http://www.irs.gov/taxpros/article/0,,id=98137,00.html>; IRS, *Understanding IRS Guidance – A Brief Primer*, available at <http://www.irs.gov/irs/article/0,,id=101102,00.html> (stating that a revenue ruling is an official interpretation by the IRS of the Internal Revenue Code, related statutes, tax treaties and regulations and the conclusion of the IRS on how the law is applied to a specific set of facts while a notice is a public pronouncement that may contain guidance that involves substantive interpretations of the Internal Revenue Code or other provisions of the law).

<sup>9</sup> However, the IRS did no more than send the church a letter of warning. See *IRS Ends Probe of California Church; Church Wants Answers*, 2007 TNT 186-2 (September 25, 2007); *IRS Probe of NAACP End; Civil Rights Group Keeps Exemption*, 2006 TNT 170-1 (September 1, 2006). The factors that may have led to these differing results

How the IRS interprets, communicates, and enforces the campaign intervention prohibition, particularly indirect intervention, has been - and continues to be - a matter of controversy. Representatives from the charitable community, both before and after the publication of Revenue Ruling 2007-41, have urged greater clarity regarding the criteria for campaign intervention. Several commentators have suggested that current rules may be unconstitutionally vague and that, to avoid this problem, violation of the campaign intervention prohibition be limited to activities involving express advocacy.<sup>10</sup> The Supreme Court's decision in *Citizen's United*, which excoriated the Federal Election Commission as a "censor" that, by embracing "the open-ended rough-and-tumble of factors," had chilled political speech of "primary importance" to the "integrity of the electoral process," has given renewed urgency to this plea.<sup>11</sup>

This difference between the IRS and the charitable community rehearses the difference between rules and standards. As Louis Kaplow has explained in an influential article, *Rules Versus Standards: An Economic Analysis*, the choice between rules and standards involves "the extent to which a given aspect of a legal command should be resolved in advance or left to an enforcement authority to consider."<sup>12</sup> By asking the IRS for clarity and bright lines in defining the prohibition, the charitable community emphasizes a key *ex ante* consideration, the impact of guidance on appropriate charitable behavior. By offering a multifactor approach dependent on the particular situation, the IRS stresses an equally important *ex post* consideration, the impact of guidance on enforcement. Both set of considerations, of course, have a place in any calculus. Kaplow's article, however, sets out a framework to help those that must give content to legal commands guidance on how to decide whether to frame such content as rules or standards. This

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include the timing of each talk, the broad ranging content of the NAACP speech itself, which took a broad historical view of civil rights issues, and the organization's history of addressing such issues.. See note 39 *infra* (listing factors IRS looks at in distinguishing issue advocacy from campaign intervention). See also <http://www.ombwatch.org/node/3608> (comparison of speeches).

<sup>10</sup> See, e.g., James Bopp, Jr. and Zachary S. Kester, *Holding the Service's Feet to the Fire: Applying Citizens United and the First Amendment to the IRC § 501(c)(3) Political Prohibition*, 11 ENGAGE (DEC. 2010), available at [http://www.fed-soc.org/doclib/20101223\\_BoppKesterEngage11.3.pdf](http://www.fed-soc.org/doclib/20101223_BoppKesterEngage11.3.pdf); Kay Guinane, *Wanted: A Bright Line Test Defining Prohibited intervention in Elections by 501(c)(3) Organizations*, 5 FIRST AMEND. L. REV. 142 (2007); Elizabeth Kingsley, *Bright Lines? Safe Harbors?* 20 Taxation of Exempts 38 Jul/Aug 2008.

<sup>11</sup> *Citizens United v. Fed. Election Comm'n*, 130 S. Ct. 876, 895-96 (2010).

<sup>12</sup> Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 561-2 (1992). I will rely primarily on his analysis in this piece, but at various places will also consider other contributions to the vast academic literature on rules versus standards.

article argues that, under Kaplow's analysis, the IRS's own concern for encouraging compliance by those subject to the law should lead it to develop more rules in this area. That is, this article emphasizes why the IRS itself should want to promulgate rules.

Part I sets forth Kaplow's analytical framework, which demands consideration not only of levels of enforcement but also how the affected community will choose to learn about the legal command in any decision between embodying legal commands as rules or as standards. Part II describes the legal commands at issue. Part III considers aspects of Kaplow's analysis related to enforcement. It examines the available sanctions, the numbers of parties subject to enforcement actions, and the kinds of sanctions in fact imposed. Part IV discusses the nature of the affected community and how members of the community will seek legal advice. Part V addresses a question Kaplow mentions frequently, but only in passing - the underlying norms a statutory command reflects. This part discusses both the legislative purpose in enacting the prohibition and attitudes toward its constitutionality. Part VI considers arguments against rules, both generally and as applied to tax law. Part VII applies the Kaplow analysis to all these considerations and concludes that the IRS should invest the time to develop a set of rules. Part VIII concludes.

#### Part I: Kaplow on Rules and Standards

According to Kaplow, in implementing a legal command, a legal authority must begin by choosing, at least to some extent, between a rule or a standard. That is, legal authorities must decide between issuing a command specified *ex ante* or wait and give the command detailed content only *ex post* in an enforcement action. That decision, however, is only the first of three stages that take place chronologically. In stage 2, individuals must decide to act and in stage 3, after individuals act, some kind of enforcement action determines application of the governing law.<sup>13</sup>

Kaplow's article focused on situations in which legislatures promulgate legal commands and courts enforce them. This analysis applies as well and in particularly interesting ways to an

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<sup>13</sup> Kaplow, *supra* note 12, at 562.

administrative agency such as the IRS,<sup>14</sup> which has a duty to ensure that the tax laws are obeyed, but must also consider how best to deploy its limited resources. The IRS is, of course, constrained both by the provisions that Congress enacts in the Internal Revenue Code and the decisions that courts issue. But it also has capacity both to interpret these Congressional commands, through various forms of administrative guidance (some of which are promulgated jointly with the Treasury Department), and to enforce them, in audits and other enforcement actions.

In Kaplow's analysis, legal authorities in weighing the costs of promulgation and the costs of enforcement should not make a decision at stage 1 without carefully considering stages 2 and 3. Cost of promulgation is important. "Rules are more costly to promulgate than standards because rules involve advance determinations of the law's content."<sup>15</sup> Nonetheless, "[i]f there will be many enforcement actions, the added cost from having resolved the issue on a wholesale basis at the promulgation stage will be outweighed by the benefit of having avoided additional costs repeatedly incurred in giving content to a standard on a retail basis."<sup>16</sup> Moreover, a rule may be preferable when the legal command governs "millions of individuals and billions of transactions,"<sup>17</sup> such as in the federal income tax, even if enforcement actions are rare. In contrast, if the relevant facts vary widely, "[d]esigning a rule that accounts for every relevant contingency would be wasteful, as most would never arise."<sup>18</sup> Situations in which a particular set of facts will occur only rarely are a better match for standards.

Legal authorities, however, need also to bear in mind the impact of their choice on the behavior of those affected by the legal command, that is, stage 2. "Being imperfectly informed of the law's commands," affected parties may act based on their best guess of the law or they may seek to acquire legal information.<sup>19</sup> They may acquire such legal knowledge by seeking professional legal advice, through study of government resources, through information disseminated by trade groups, other third-party resources, or other means. On the basis of this

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<sup>14</sup> In any case involving promulgation of regulations, the Treasury Department will be involved as well as the IRS. See authorities cited in Hickman, *supra* note 8, at 240 n.4.

<sup>15</sup> Kaplow, *supra* note 12, at 562.

<sup>16</sup> *Id.* at 563, footnote omitted.

<sup>17</sup> *Id.* at 564. Kaplow refers specifically to tax as an example.

<sup>18</sup> *Id.* at 563.

<sup>19</sup> *Id.* at 562.

legal information, they may decide to avoid conduct that they learn is illegal or subject to sanctions to which they do not wish to become subject. Legal knowledge may also lead them to engage in conduct that they had mistakenly thought was forbidden or subject to sanctions they thought severe but are in fact quite minor.<sup>20</sup>

Affected parties must decide how much to invest in learning about the content of a legal command. The value of obtaining professional legal advice or learning in other ways about the law depends on the value the parties place on conduct from which they are deterred and the value they place on conduct they now feel free to undertake.<sup>21</sup> Importantly, to Kaplow, the decision on how much to invest to learn about the content the authority has given to a legal command is likely to differ depending on whether the content is a rule or a standard. “Because a standard requires a prediction of how an enforcement authority will decide questions that are already answered in the case of a rule, advice about a standard is more costly.”<sup>22</sup> As a result, affected parties may well choose not to become as well informed regarding standards. Thus, a rule could improve compliance. “Substantial compliance with imperfect rules” may yield better results than “poor compliance with more nearly perfect standards.”<sup>23</sup> Frequency is again important. “[T]he number of individuals who incur the cost of legal advice may greatly exceed the number who are subject to complete enforcement proceedings.”<sup>24</sup> Thus, Kaplow suggests, while standards have an important role to play in ensuring accurate enforcement actions, rules offer two possible sources of benefit: (1) individuals may need to spend less time learning their content and (2) they may become better informed about rules than standards and thus better conform their behavior to the law.<sup>25</sup>

Kaplow’s framework will help clarify the differences between the IRS and many members of the charitable community in approaching the campaign intervention prohibition. It directs us to ask a number of questions about enforcement - the available sanctions, the numbers of parties subject to enforcement actions and the kinds of sanctions in fact imposed. But it

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<sup>20</sup> *Id.* at 571.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 569

<sup>23</sup> *Id.* at 608 n. 138.

<sup>24</sup> *Id.* at 574.

<sup>25</sup> *Id.* at 577.

charges us as well to consider the number and nature of parties subject to the legal command, whether they are likely to seek legal advice, and the nature of legal advice they are likely to consult. Underlying all of Kaplow's analysis is a concern that a legal command conform to its underlying norms. He also gives significant attention to issues of complexity. All of these factors bear upon whether a rule or a standard is most likely to achieve the highest possible level of compliance.

## Part II: The Legal Commands at Issue

In the first instance, it is Congress that has issued the legal commands regarding the political campaign prohibition. As stated earlier, section 501(c)(3) of the Internal Revenue Code provides that an organization cannot be exempt under that provision and “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.” The provision was first introduced as part of the 1954 Internal Revenue Code.<sup>26</sup> Congress amended the provision in 1987 to prohibit opposing as well as supporting any candidate.<sup>27</sup>

In general and subject to various limits, contributions to section 501(c)(3) organizations are tax-deductible for purposes of the income tax. Section 170(c)(2)(d), a provision dating to 1969 that codified a Treasury regulation,<sup>28</sup> specifies that, in order to be charitable contribution deductible for income tax purposes, a contribution or gift must, among other requirement, be to

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<sup>26</sup> See Roger Colinvaux, *Citizens United and the Political Speech of Charities*, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1726407](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1726407). I note that the staff of Senator Grassley, former ranking minority member of the Senate Finance Committee, recently recommended that the campaign intervention prohibition be eliminated or circumscribed. See Memorandum from Theresa Pattara and Sean Barnett to Senator Grassley re Review of Media Based Ministries, dated Jan. 6, 2011 (“Senate Staff Memorandum”), available at <http://finance.senate.gov/newsroom/ranking/release/?id=5fa343ed-87eb-49b0-82b9-28a9502910f7>. Grassley, however, did not endorse any of the recommendations in the staff report. Instead, he referred the issues to a commission to be headed by the Evangelical Council of Financial Accountability. *Id.* I will address a number of issues raised by the staff report later in this piece. Generally, however, I observe that this staff recommendation flies in the face of the long history of the prohibition, see Colinvaux, *supra*. It also fails to consider that we as a nation have a policy of requiring all contributions for political campaigns to come from after-tax income, other policy reasons that favor the prohibition, or the abuses that could follow repeal of the prohibition. See Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations after Citizens United*, forthcoming 10 ELECTION L.J.; Donald B. Tobin, *Political Campaigning by Churches and Charities*, 95 GEO. L. J. 1313 (2007); Gregg D. Polsky, *A Tax Lawyer's Perspective on Section 527 Organizations*, 28 Cardozo L. Rev. 1773 (2007).

<sup>27</sup> Revenue Act of 1987, PL. 100-23, sec. 10711(a)(2).

<sup>28</sup> See Colinvaux, *supra* note 26. The gift and estate taxes also provide for a charitable contribution deduction, although the wording is not identical to section 170(c)(12)(d). See sections 2055(a)(2); 2522(a)(2).

or for the use of an entity “which does not participate in, or intervene in (including the publishing or distributing of statements) to any political campaign on behalf of (or in opposition to) any candidate for public office.”

In 1987 Congress also gave the IRS some additional tools to enforce the campaign intervention prohibition. It provided that any organization losing its exempt status under section 501(c)(3) because of substantial lobbying or violating the campaign intervention prohibition cannot at any time thereafter be treated as a section 501(c)(4) organization.<sup>29</sup> It enacted section 4955, an excise tax on violations of the prohibition. Under this provision, a two-tier excise tax applies to amounts paid or incurred for campaign intervention. The initial section 4955 excise tax on the organization is 10 percent of each forbidden campaign intervention expenditure, with a separate tax of 2-1/2 percent on a knowing organization manager (up to \$5000) in certain circumstances.<sup>30</sup> If the campaign intervention is not corrected within a specified period of time, by recovering part or all of the expenditures to the extent possible and by establishing safeguards to prevent future campaign intervention,<sup>31</sup> second tier taxes of 100% on the organization and 50% (up to the \$10,000) on the knowing manager.<sup>32</sup> If correction is accomplished and the expenditure was not “willful and flagrant,” the IRS can waive the first tier tax.<sup>33</sup>

According to the legislative history of the provision, the section 4955 excise tax was enacted to be imposed, in most cases, in addition to and not in lieu of revocation.<sup>34</sup> If the political campaign intervention involves little out of pocket expense, the excise tax has little bite. When a violation of the campaign intervention prohibition is flagrant, however, the IRS can

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<sup>29</sup> Sec. 504(a).

<sup>30</sup> Sec. 4955(a), (c).

<sup>31</sup> Sec. 4955(f)(4).

<sup>32</sup> Sec. 4955(b), (c).

<sup>33</sup> Sec. 4962(c), Treas. Reg. sec. 53.4955-1(d)(e).

<sup>34</sup> “The adoption of an excise tax sanction does not modify the present-law rule that an organization does not qualify for tax-exempt status as a charitable organization, and is not eligible to receive tax-deductible contributions unless the organization does not participate in, or intervene in, any political campaign on behalf of or in opposition to any candidate for public office.” H.R. Rep. No. 100-391, 100<sup>th</sup> Cong., 1<sup>st</sup> Sess. 1623-24 (1987). The regulations under section 4955 also make this point: “The excise taxes imposed by section 4955 do not affect the substantive standards for tax exemption under section 501(c)(3) under which an organization is described in section 501(c)(3) only if it does not participate or intervene in any political campaign on behalf of any candidate for public office.” Treas. Reg. sec. 53.4955-1(a).

make an immediate termination assessment of tax due and also file an action in federal district court to halt or enjoin future campaign intervention if certain procedural requirements are met.<sup>35</sup>

Regulations, the most authoritative form of administrative guidance,<sup>36</sup> provide some additional interpretation regarding the Congressional commands, but do not set out any bright rules. The regulations under section 501(c)(3) explain that an organization cannot be exempt under that provision if it is an “action” organization and that an action organization includes an organization that violates the campaign intervention prohibition. The regulations explain, most unhelpfully, that activities violating the campaign intervention prohibition “include, but are not limited to, the publication or distribution of written or printed statements or making of oral statements on behalf of or in opposition to . . . a candidate.”<sup>37</sup>

Revenue rulings involving this issue give additional guidance, but always with the caveat that the determination of whether a violation of the prohibition has occurred is a question of facts and circumstances. Thus, Revenue Ruling 2007-41 lists several categories that raise the potential for campaign intervention<sup>38</sup> and factors to be considered for a number of such categories. It offers as well 21 examples. In the case of candidate appearances, for example, factors include whether the organization provides other candidates with an equal opportunity to participate, whether the organization indicates any support or opposition to the candidate, and whether any political fundraising occurs.<sup>39</sup>

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<sup>35</sup> Sec. 6852, sec. 7409. There is no evidence that the IRS has ever asserted the authority to halt or enjoin future campaign intervention.

<sup>36</sup> See authorities cited in Hickman, *supra* note 8, at 240 n. 4.

<sup>37</sup> Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(i); 1.501(c)(3)-1(c)(2)(iii).

<sup>38</sup> Rev. Rul. 2007-41, *supra* note 8. They are: 1) voter education, voter registration and get out the vote drives; 2) individual activity by organization leaders; 3) candidate appearances; 4) candidate appearance where speaking or participating as a non-candidate; 5) issue advocacy vs. political campaign intervention; 6) business activity and 7) web sites.

<sup>39</sup> *Id.* In distinguishing issue advocacy from political campaign intervention, the revenue ruling lists seven factors: whether the statement at issue identifies one or more candidates for a given public office; whether it expresses approval or disapproval for one or more candidates' positions and/or actions; whether the statement is delivered close in time to the election, whether it makes reference to voting or an election; whether the issue addressed in the communication has been raised as an issue distinguishing candidates for a given audience; whether the communication is part of an ongoing series of communications by the organization on the same issues that are made independent of any election; and whether the timing of the communication and identification of the candidates are related to a non-electoral event such as a scheduled vote on specific legislation by an officeholder who also happens to be a candidate for public office. The ruling does note that a “communication is particularly at risk of political intervention when it makes a reference to candidate or voting in a specific upcoming election.” It then backs away

The meaning of some of these factors is itself uncertain. What, for example, indicates support or opposition during a candidate appearance? Neither do we know what weight to assign to each factor. In addition, whenever, “open-ended rough-and-tumble of factors,”<sup>40</sup> using the Supreme Court’s language in *Citizens United*, are applied to a particular factual situation, the result will be uncertain if different factors point in different directions. An exempt organization can have no confidence that its conclusion would be the same as that of the IRS.

An earlier revenue ruling on voter guides further illustrates the difficulty. Revenue Ruling 78-248<sup>41</sup> cautions that campaign intervention “depends on all the facts and circumstances.” It then distinguishes certain voter guides that would be permissible voter education activities for a section 501(c)(3) organization from some that would constitute impermissible campaign intervention. In one permissible situation, the organization annually prepared and made generally available to the public a compilation of the voting records of all Members of Congress on major issues involving a wide range of subjects, without editorial opinion and without anything in its structure or contents to imply approval or disapproval of any Member or the Member’s voting record.<sup>42</sup> In one of the impermissible situations, an organization primarily concerned with land conservation matters published a voter guide widely distributed during an election campaign that was a factual compilation of incumbent’ voting records on selected land conservation issues. However, because the guide emphasized one area, the ruling concluded that its purpose was not non-partisan voter education but forbidden political intervention.

Again, the ruling leaves organizations seeking guidance with a number of questions. What is “a wide variety of issues”? How many issues are enough? Can an organization, for example, emphasize a few issues, listed without editorial comment, if they are those that reflect particular political leanings, such as those on the left or the right? We do not know.

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from even this statement by cautioning, “Nevertheless the communication must still be considered in context before arriving at any conclusions.”

<sup>40</sup> 130 S.Ct. at 896, quoting *FEC v. Wis. Right to Life*, 551 U.S. at 469 (opinion of Roberts, C.J. (quoting *Jerome B. Grubart, Inc. v. Great Lakes Dredge & Dock Co.*, 513 U.S. 527, 547)).

<sup>41</sup> Rev. Rul. 78-248, 1978-1 C.B. 154.

<sup>42</sup> *Id.*

As the Congressional Research Service has observed, “[N]either tax law nor the regulations offer much insight as to what activities are banned for 501(c)(3) organizations prohibited from intervening in political campaigns.”<sup>43</sup> The same is true in the case of revenue rulings. In short, the legal commands from Congress and precedential guidance, which is that included in the IRS cumulative bulletin,<sup>44</sup> provide standards and not rules.

### III. Enforcement of the Campaign Intervention Prohibition

A key factor in Kaplow’s analysis is the level of enforcement of a legal command.<sup>45</sup> The defining characteristic of a standard is that it is imbued with more specific content only through *ex post* enforcement actions. Thus, a low level of enforcement actions would suggest that legal authority promulgate a standard instead of a rule because of the added cost of promulgating a rule. In the case of the campaign intervention prohibition, however, IRS enforcement has, as others have noted, “been spotty at best.”<sup>46</sup>

Judicial decisions, of course, are one means of explaining the content of the legal rule *ex post*. Only a very small number of court decisions have involved the campaign intervention prohibition. The best known case is the 2000 decision in *Branch Ministries*.<sup>47</sup> There a church had purchased full page ads in two national newspapers stating that voting for then-Presidential candidate Bill Clinton was sinful and asked for tax-deductible donations. The IRS revoked the church’s exemption, an action that the appellate court upheld. The case involved undisputed express intervention and thus gives little guidance for the more difficult situation of indirect intervention. Similarly, in the case of the Christian Echoes Ministry, whose revocation of exemption the Tenth Circuit upheld in 1972, the political intervention was clear. Christian

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<sup>43</sup> Erika Lunder, Congressional Research Service, *Report on Tax Exempt Organizations: Political Activity Restrictions and Disclosure Requirements* (Jan. 25, 2007), 2007 TNT 36-25 (Feb. 22, 2007).

<sup>44</sup> See IRS, *Internal Revenue Code, Treasury (Tax) Regulations, Other Official Guidance*, available at <http://www.irs.gov/taxpros/article/0,,id=98137,00.html>.

<sup>45</sup> Chronologically, enforcement occurs at stage 3, but because of its importance in Kaplow’s calculus, I discuss it first.

<sup>46</sup> Lloyd Hitoshi Mayer, *Gasping Smoke: Enforcing the Ban on Political Activity by Charities*, 6 FIRST AMEND. L. REV. 1, 4 (2007); Donald B. Tobin, *Political Campaigning by Churches and Charities*, 95 GEO. L. J. 1313, 1357 (2007) (“sporadic and potentially uneven enforcement”). I note that this article in many places updates Mayer’s work and thank him for his efforts.

<sup>47</sup> *Branch Ministries v. Rossotti*, 211 F.3d 137 (D.C. Cir. 2000).

Echoes had attacked various candidates it considered too liberal and endorsed conservative candidates, such as Barry Goldwater.<sup>48</sup>

*Association of the Bar of the City of New York v. Commissioner*, however, offered guidance on a more subtle form of possible political intervention, voter guides. The New City Bar, a section 501(c)(6) trade association seeking status as a charitable and educational organization under section 501(c)(3), rated candidates for both appointive and elective judgeships at all levels of government as “approved,” “not approved,” or “approved as highly qualified” on the basis of professional ability, experience, character, temperament and possession of any special qualifications. The Second Circuit held that such activity, which the Bar Association conceded was intended to ensure that unqualified candidates were not elected to office, violated the political intervention prohibition, citing the Treasury regulation forbidding intervening “directly or indirectly.”<sup>49</sup> Conducting the evaluations on a nonpartisan basis did not change the conclusion.

A recent case, *Catholic Answers, Inc. v. United States*<sup>50</sup> sought to limit the political intervention ban to express advocacy. Catholic Answers, a tax exempt religious corporation challenged political activity excise taxes imposed against it under section 4955 for posting e-letters from its founder and president criticizing John Kerry, the then presumptive Democratic Party presidential nominee. The organization was assessed and paid both first tier taxes and second tier taxes to correct the campaign intervention expenditure. It also requested a refund of the taxes paid, and the IRS abated the refund claim, as permitted by section 4962, on the grounds that the campaign intervention “was not willful and flagrant and was corrected within the correction period.” Catholic Answers nonetheless filed suit challenging regulations addressing political intervention under sections 4955 and 501(c)(3) on the grounds that they are unconstitutional for lacking specificity, for being overbroad, and for encompassing speech not limited to express advocacy or direct contributions. The court, however, dismissed the complaint

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<sup>48</sup> *Christian Echoes National Ministry, Inc. v. United States*, 470 F.2d 849 (10<sup>th</sup> Cir. 1972, *cert. denied*, 414 U.S. 684 (1973).

<sup>49</sup> *Ass’n of the Bar of the City of New York v. Comm’r.*, 858 F.2d 876, 881 92d Cir. 1988), *cert. denied* 490 U.S. 1030 (1989) (citing Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iii). A number of revenue rulings also address voter guides. See Rev. Rul. 78-248; Rev. Rul. 80-282. See *supra* notes for discussion of Rev. Rul. 78-248.

<sup>50</sup> *Catholic Answers v. U.S.*, 2009 TNT198-13 (Oct. 16, 2009).

on the basis that the IRS abatement had rendered the refund claim moot and that, since Catholic Answers had formed a new 501(c)(4) organization to engage in political intervention, there were no issues capable of repetition yet evading review. Thus, the case did not provide any additional explication of the reach of the campaign intervention prohibition.

Enforcement activity of the campaign intervention prohibition also takes place short of judicial decisions. The IRS may revoke exempt status or impose the campaign intervention excise tax in administrative proceedings. Several constraints limit the usefulness of such activity in giving content to the campaign intervention prohibition. First, the IRS audits only a small number of exempt organizations. The 2010 Annual Report from the IRS Exempt Organizations Division reported 10,187 returns examined in fiscal year 2009 through traditional examinations and 6,773 through less resource-intensive compliance checks.<sup>51</sup> The reported numbers for fiscal year 2010 were 11,449 and 3,893, respectively.<sup>52</sup>

With 776,300 returns processed for Calendar Year 2009,<sup>53</sup> the percentage of examinations would be approximately 1.47 percent for 2010, using the same number for returns processed for both years. However, this percentage is somewhat misleading. A report on fiscal year 2010 EO examinations shows that of the 11,449 returns examined in 2010 only 3,596 were Forms 990 and 990-EZ, the annual information return required of most tax-exempt organizations.<sup>54</sup> Thus, the percentage of such returns examined out of the number of such returns filed drops down to approximately .463%. Moreover, for purposes of these statistics, “examined” means “closed,” and an exempt organization audit may cover one, two or three years of returns, all of which are closed in a single year. Thus, the number of organizations examined may be even lower.<sup>55</sup> These numbers are far lower than audits of both personal returns and for-profit entities.<sup>56</sup> Moreover, while in recent years redacted revocations of exempt status have

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<sup>51</sup> Compliance checks inquire about an item on a return or solicit information about an organization’s operations. *IRS EO Division Publishes Annual Report, Workplan for New Fiscal Year*, 2010 TNT 241-19 (Dec. 16, 2010), also available at [http://www.irs.gov/pub/irs-tege/fy2011\\_eo\\_workplan.pdf](http://www.irs.gov/pub/irs-tege/fy2011_eo_workplan.pdf) (“2010 Report”).

<sup>52</sup> *Id.*

<sup>53</sup> IRS Data Book, FY 2010, Table 13, available at <http://www.irs.gov/pub/irs-soi/10db13eo.xls>. The 2010 Report does not give this data.

<sup>54</sup> *Id.* The vast majority of other returns examined were employment tax returns. *Id.*

<sup>55</sup> Paul Streckfus, editor of the EO TAX JOURNAL, estimates the rate at .2%. EO Tax Journal Update 2010-172 (Friday November, 19, 2010) on file with author.

<sup>56</sup> See *infra* note 90.

been publicly available, administrative enforcement actions are confidential and the details of particular cases become public only if the organization chooses to make them so.<sup>57</sup>

Some additional data on an aggregate basis are available, however. In 2007, Professor Lloyd Mayer noted that IRS excise tax statistics for 2003 through 2005 report that on average fewer than twenty organizations per year paid the excise for political expenditures under section 4955, disqualifying lobbying expenditures under section 4912, or premiums paid on personal benefit contracts, was with an average paid for all three of these taxes of less than \$5,500 per year.<sup>58</sup> For calendar year 2010, the number if charities, private foundations and split interest trusts that paid tax on political expenditures was 32 and the total amount paid \$40,413, for an average of \$1,304;<sup>59</sup> for 2009, the number of charities, private foundations and split interest trust paid tax on these expenditures was 48, and the total amount paid \$1,371,176, for an average of \$28,566. For calendar year 2008, the number of charities, private foundations and split interest trusts paying such taxes totaled 30 with total payments of \$84,665, or an average of \$2,822.<sup>60</sup> Thus, imposition of the section 4955 excise tax occurs only rarely and in small amounts.

Mayer reported a total of only 60 revocations of charities over two and one-half years between 2005 and 2007.<sup>61</sup> From January 1, 2010 through April 4, 2011 alone, the IRS revoked the charitable status of 212 organizations.<sup>62</sup> The results of the Political Activity Campaign Initiative discussed below, however, indicate that only a few of these revocations related to campaign intervention. More frequently revocations or denials of initial applications for recognition of exempt status occur for failure to file required forms or as a result of private

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<sup>57</sup> See, e.g., Press Release, The Christian Broadcasting Network Hour (March 16 1998), 95 TNT 55-78 (announcing that the IRS had revoked the tax-exempt status of Pat Robertson's Christian Broadcasting Network and three of its former affiliates because of campaign intervention); Press Release Old Time Gospel Hour (Feb. 17. 1003), announcing that the IRS had revoked the tax-exempt status of Jerry Falwell's Old Time Gospel; Hour for 1986 and 1987 for campaign intervention), *cited in* Mayer, *supra* note 46, at 11 n. 34.

<sup>58</sup> Mayer, *supra* note 46, at 12 n. 36.

<sup>59</sup> The IRS now aggregates the categories listed by Mayer with with such items as tax on prohibited tax shelters, and taxable distribution of sponsoring organizations. SOI Tax Statistics, Excise Taxes Reported by Charities, Private Foundations and Split Interest Trusts on Form 4729, Calendar Year 2009, *available at* <http://www.irs.gov/taxstats/charitablestats/article/0,,id=97176,00.html#2>.

<sup>60</sup> SOI Tax Statistics, Excise Taxes Reported by Charities, Private Foundations and Split Interest Trusts on Form 4729, Calendar Year 2008, *available at* <http://www.irs.gov/taxstats/charitablestats/article/0,,id=97176,00.html#2>.

<sup>61</sup> Mayer, *supra* 46, at 12 n. 35.

<sup>62</sup> See Recent Revocations of 501(c)(3) Determinations, *available at* <http://www.irs.gov/charities/charitable/article/0,,id=141466,00.html>.

inurement, that is, self-dealing by organization insiders.<sup>63</sup> One recent denial of exemption did cite the campaign intervention prohibition, as one reason for the action, on the grounds that the organization donated office space and telephone lines to an affiliated section 527 organization without charging for their use and allowed candidates to speak at the organization's events.<sup>64</sup> In 2007, the IRS revoked the exemption as a section 501(c)(3) organization of an entity that placed two newspaper advertisements opposing a candidate's bid for office, made two massive mailings to the general public, and had a truck with signs opposing the candidate's ticket driven across country for four months.<sup>65</sup>

That is not to say that redacted guidance is without relevance to the enforcement of the campaign intervention prohibition. The IRS also publishes redacted Technical Advice Memorandum (TAM), answers by the Office of Chief Counsel to questions that arise in the field, usually during examinations.<sup>66</sup> A 2009 TAM found prohibited campaign intervention by a charity for failing to distinguish web pages containing candidate-related material from its other web pages when the website was operated jointly by the charity and its affiliated social welfare organization.<sup>67</sup> A 2004 TAM concluded that a charity's administration of a payroll deduction plan allowing contributions to an industry political action campaign violated the campaign intervention prohibition and justified imposition of the section 4955 excise tax.<sup>68</sup> In 1998, a TAM concluded that a loan to a political organization violated the campaign intervention prohibition because a contribution to a political organization is defined to include a loan and that the loan transaction justified imposition of the section 4955 excise tax.<sup>69</sup>

By far the best evidence of IRS enforcement policy in this area and the public's understanding of and compliance with the prohibition, however, is the IRS Political Activity

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<sup>63</sup> For the period examined revocations of exemptions for credit counseling organizations were particularly numerous. See, e.g., PLR 201017077, 200950051, 200915059. Congress in 2006 enacted new standards applicable to exemption by credit counseling organizations. Pension Protection Act of 2006, P.L. 109-280 § 1220(a), codified as § 501 (q).

<sup>64</sup> PLR 201020021 (Feb. 25, 2010).

<sup>65</sup> PLR 200724033 (April 16, 2007).

<sup>66</sup> See IRS, *Understanding IRS Guidance – A Brief Primer*, available at <http://www.irs.gov/irs/article/0,,id=101102,00.htm>. TAMs are the basis for revenue rulings, as the introduction to each volume of the IRS Cumulative Bulletin explains.

<sup>67</sup> TAM 200908050 (Feb. 20, 2009).

<sup>68</sup> TAM 200446033 (Nov. 12, 2004).

<sup>69</sup> TAM 9812001 (March 20, 2008). For description of the few other TAMs since 1991 involving the campaign intervention prohibition, see Mayer, *supra* note 46, at 12 n 37.

Campaign Initiatives (“PACI”) for 2004, 2006, and 2008. As the report Final Report regarding the 2004 PACI explains, an important objective of the project was “to establish the IRS enforcement presence.”<sup>70</sup> Based on referrals,<sup>71</sup> the IRS examined on an expedited and focused basis possible campaign intervention in each of those election cycles. In so doing, it distinguished between single issue cases and more complicated ones involving multiple issues. In the 2004 and 2006 election cycles, violations were evenly split between churches and other type of section 501(c)(3) organizations, and the IRS undertook to follow the procedural requirements for church audits.<sup>72</sup>

In 2004, the IRS received 166 referrals and selected 100 organizations for examination and found violations in nearly 75% of the organizations examined. The most common violations identified were distribution of printed documents supporting candidates, statements endorsing candidates during normal services, well-known individuals endorsing a candidate at an official function, candidates speaking at official functions, distributions improper voter guides or candidate ratings, posting of signs on the organization’s property, endorsing candidates on the organization’s website or though links on its website, verbal endorsements by an organizations official, political contributions to a candidate, non-candidate endorsement of a candidate at an official function of the organization.<sup>73</sup>

The statutory prohibition by its terms is absolute such that even a de minimis amount of political campaign intervention could result in loss of exemption. The lack of statutorily authorized intermediate sanctions complicates enforcement.<sup>74</sup> That is, the statute gives no option

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<sup>70</sup> *IRS Releases Results of Political Activity Audits of Charities*, 2006 TNT 38-10 (Feb. 27, 2006) (“2004 PACI Report”), also available at <http://www.irs.gov/charities/article/0,,id=154622,00.html>.

<sup>71</sup> For criticism of IRS reliance on referrals, see Mayer, *supra* note 46, at 25-27.

<sup>72</sup> See sec. 7611. The IRS regulations implementing this code section were subsequently held invalid. *United States v. Living Word Christian Center*, 2009 U.S. Dist. LEXIS 6902 (D.C. D. Minn. 2009). The IRS has proposed but not finalized new regulations. See *Proposed Regs Amend Q&A’s for Church Tax Inquiries, Exams*, 2009 TNT 146-15 (Aug. 3, 2009); *IRS, Treasury Release 2010-2011 Priority Guidance Plan*, 2010 TNT 235-25 (Dec. 8, 2010) (including final 7611 regulations).

<sup>73</sup> *IRS Reports on Charities’ Campaign Activities for 2006 Cycle*, 2006 Political Activities Compliance Initiative, 2007 TNT 108-45 (June 5, 2007), also available at [http://www.irs.gov/pub/irs-tege/2006paci\\_report\\_5-30-07.pdf](http://www.irs.gov/pub/irs-tege/2006paci_report_5-30-07.pdf). See also *Referrals of Possible Campaign Intervention by Charities Not Always Promptly Processed Timely*, Says TIGTA, 2008 TNT 127-5 (July 1, 2008).

<sup>74</sup> The Senate Staff Memorandum, *supra* note , notes this problem but does not suggest amending the statute to include sanctions short of revocation.

but revocation for even the smallest violation, but the IRS is understandably hesitant to invoke such a severe sanction for minor violations. In the 2004 PACI, the IRS revoked exemption in five cases and proposed revocation in two more, although one revocation related to issues other than campaign intervention.<sup>75</sup> In 66% of 2004 PACI cases, however, the IRS essentially engaged in self-help regarding available sanctions by issuing written advisories, as it did in connection with All Saints Episcopal Church. The reason for these advisories, it explained, was that “the act of intervention was shown to be a one-time, nonrecurring nature or was taken in good faith reliance on advice of counsel or was otherwise shown to be an anomaly; the organization corrected the intervention, including recovery of expenditures, to the extent possible, and established that it had taken steps to prevent any future political intervention within the meaning of section 501(c)(3), and the assessment of the section 4955 tax was unavailable.”<sup>76</sup> The report on the 2004 PACI was careful to specify that “the term ‘no-change written advisory’ has a broader meaning in the context of PACI than it is usually understood to mean.” It was not being limited to issues or activities that were insubstantial, but “if conducted to a greater extent, could affect the organization’s exempt status,”<sup>77</sup> since technically under the law, any amount of campaign intervention, no matter how small, results in loss of exemption. The report specifically noted confusion with the meaning of the language of the statutory prohibition and that “[e]specially, though not exclusively in cases concerning churches, the phrase had been interpreted to mean that the prohibition on political intervention . . . was limited to expressly endorsing or opposing candidates.”<sup>78</sup>

The IRS repeated the program in 2006;<sup>79</sup> referrals increased to 237, but the IRS selected 100 for examination, with results similar to that for 2004. Unlike the 2004 efforts, however, it identified 6 cases in which an organization’s facilities were used for political campaign

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<sup>75</sup> *IRS Report*, *supra* note 73 at 30.

<sup>76</sup> *Id.* at 18

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at 21-22.

<sup>79</sup> 2006 Political Activities Compliance Initiative, available at [http://www.irs.gov/pub/irs-tege/2006paci\\_report\\_5-30-07.pdf](http://www.irs.gov/pub/irs-tege/2006paci_report_5-30-07.pdf). A report of the Treasury Inspector General for Tax Administration regarding the 2004 PACI urged greater guidance to IRS examiners and state more clearly in closing letters whether a prohibited political activity violation was substantial. See *TIGTA Examines Political Intervention by Tax-Exempt Organizations in 2004 Elections*, 2009 TNT 94-33 (May 19, 2009). In its examination of the 2006 PACI, TIGTA said the IRS had improved but nonetheless recommended that organizations be notified more promptly regarding the examination. See *Referrals of Possible Campaign Intervention by Charities Not Always Promptly Processed Timely*, Says TIGTA, 2008 TNT 127-5 (July 1, 2008).

intervention.<sup>80</sup> It also undertook a follow-up process for its 2004 examinations and found no repeat campaign intervention. In addition, unlike the 2004 efforts, the IRS also conducted independent research on various state campaign finance report databases and found 269 apparent cases of direct contributions to candidates. It found the same types of violations as it had in the previous election cycle, but did not revoke or propose revocation in any case. It issued written advisories in 65% of cases.<sup>81</sup>

The IRS continued the Political Activity Compliance Initiative in 2008, with an announced emphasis on internet activity.<sup>82</sup> The only information on the 2008 PACI is some summary data included in the 2010 Annual Report from the Director, Exempt Organizations.<sup>83</sup> According to the 2010 Annual Report, the IRS investigated 133 allegations of political activity for the 2008 election cycle, more than in 2004 and 2006. Few other results of the investigations are not given. The 2008 PACI involved the same categories of violations; unlike 2006, however, no data on political contributions was included. The 2008 PACI included 47 allegations of a church official endorsing a candidate during normal services, as compared to 19 in 2006 and 14 in 2007.<sup>84</sup> Thus, the earlier PACIs and attempts at education, including publishing a revenue ruling and a guide for churches and religious organizations, discussed below,<sup>85</sup> did not result in any clear evidence of increased compliance in this area.

The 2010 Report states that the IRS revoked the tax-exempt status of seven non-compliant organizations over the three years of the PACI. When the 2010 Report was released, Lois Lerner, Director, Exempt Organizations explained that investigations showed substantiation of allegations against more than half of the organizations, with most receiving only a warning. The three most common complaints were church officials making a statement for or against a candidate during normal services, exempt organizations distributing printed documents supporting candidates, and organizations endorsing candidates on their websites or through links

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<sup>80</sup> *Id.* at 4.

<sup>81</sup> *Id.* at 5.

<sup>82</sup> IRS Continues Program on Political Activity by Charities: Stresses Education and Enforcement, IR-208-61 (April 17, 2008), available at <http://www.irs.gov/newsroom/article/0,,id=181570,00.html>.

<sup>83</sup> IRS EO Division Publishes Annual Report, Workplan for New Fiscal Year, 2010 TNT 241-19 (Dec. 16, 2010), also available at [http://www.irs.gov/pub/irs-tege/fy2011\\_eo\\_workplan.pdf](http://www.irs.gov/pub/irs-tege/fy2011_eo_workplan.pdf).

<sup>84</sup> See text *infra* at notes 137-139 for discussion of an initiative by one church group that may have produced or at least influenced these figures.

<sup>85</sup> See text at notes 106-110 *infra*.

to their websites. Close behind were organizations making political contributions to candidates.<sup>86</sup>

The 2010 Report also observed that the data did not include complaints for the 2010 election year because they were still going through the classification process. Moreover, it stated that the IRS has moved from project to process, meaning that it will be “winding down . . . separate, formal projects, and assimilating them into our general casework.” The IRS had not indicated publicly any intention to conduct a Political Activity Compliance Initiative for 2010.<sup>87</sup> That is, we can expect no further PACI efforts. Thus, a high profile enforcement undertaken by the Political Campaign Initiative has fizzled away.

Even with the sustained audit of the Political Activity Compliance Initiative, levels of enforcement of the complain intervention prohibition have been low, relying primarily on referrals, rather than any systematic audit or examination by the IRS. Under stage 1 of Kaplow’s calculus, so low a level of enforcement activity usually favors the development of standards, because “the added cost from having resolved the issue on a wholesale basis at the promulgation state” will not “be outweighed by the benefit of having avoided additional costs repeatedly incurred in giving content to a standard on a retail basis.”<sup>88</sup> Kaplow also observes that if the relevant facts vary widely, “[d]esigning a rule that accounts for every relevant contingency would be wasteful, as most would never arise.”<sup>89</sup> Situations in which a particular set of facts will occur only rarely, call for standards. The IRS routinely cautions that violations depend on facts and circumstances. Yet the results of the PACI in fact suggest that violations fall into clear and relatively few categories.

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<sup>86</sup> *Political Activity Revocations Reported; IRS Work Plan Outlines 501(c)(4) Focus*, BNA Money & Politics Report, available at [http://news.bna.com/mpdm/MPDMWB/split\\_display.adp?fedfid=18838983&vname=mpebulallissues&fn=18838983&jd=a0c5r5r3a1&split=0](http://news.bna.com/mpdm/MPDMWB/split_display.adp?fedfid=18838983&vname=mpebulallissues&fn=18838983&jd=a0c5r5r3a1&split=0). It is not clear to what extent these violations involved direct or indirect intervention. For example, we do not know what kind of statements church officials made, whether they were express advocacy or statements at the margin between intervention and issue advocacy. Nonetheless, the 2010 Report belies the argument made by the Senate Staff Memorandum, *supra* note 26, that enforcement of the prohibition is not feasible. Statements made at church services may be difficult to detect, but voter guides, candidate contributions, and statements on web pages are not.

<sup>87</sup> See Erika Lunder, *CRS Analyzes Restrictions, Requirements of Tax-Exempt Organizations* (Oct. 1, 2010), 2010 TNT 190-34.

<sup>88</sup> Kaplow, *supra* note 12, at 563, footnote omitted.

<sup>89</sup> *Id.* at 563.

Kaplow, as noted earlier, cautions that when a legal command affects millions, a rule may be preferable even when enforcement activity is low. He uses tax, which is well-known for its enormous number of rules, as an example of such a category. Audit rate is low for all taxpayers, not just section 501(c)(3) organizations.<sup>90</sup> The intervention prohibition applicable to section 501(c)(3) organizations affects hundreds of thousands of organizations,<sup>91</sup> and this fact argues for rules rather than standards, despite the low level of enforcement. Moreover, in the case of section 501(c)(3), the number of organizations subject to the prohibition is closely related to the nature of those subject to the legal command, which figures prominently in Kaplow's stage 2, to which we now turn.

#### IV. The Affected Community

Equally important to the Kaplow calculus is the nature of the community affected by the legal command because the nature of the community shapes how members of the community will learn about it. "Being imperfectly informed of the law's commands," Kaplow posits, affected parties may act based on their best guess of the law or they seek to acquire legal information.<sup>92</sup> Those in this community may acquire such legal knowledge by seeking professional legal advice, through study of government resources, through information disseminated by trade groups, other third-party resources, or other means. They will do so only if they believe that the perceived value of acquiring legal advice to guide their behavior exceeds the perceived costs of doing so,<sup>93</sup> and the costs of acquiring legal advice about a standard are greater than those of acquiring such advice about a rule.<sup>94</sup> Thus, it is important to consider whether members of the affected community have the resources to acquire legal advice about the

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<sup>90</sup> The IRS audited 1.1% of all personal returns in fiscal year 2010, the highest rate in a decade. Audits for small businesses (those with less than \$10 million in assets) increased to 0.94 percent from 0.85 percent in 2009. Those for midsize corporate taxpayers (those with between \$10 million and \$50 million in assets) increased to 10.95 percent from 10.10 percent in 2009. Audits for the largest corporations declined in 2010, from 25% in 2009 to 23 percent in 2010. In 2005, the ten year high, audit rates for the largest corporations was 44 percent. See *Tax Practitioners Expect More Audit Growth in 2011*, 2010 TNT 242-5 (Dec. 17, 2010); *IRS Releases Fiscal 2010 Enforcement Statistics*, 2010 TNT 241-17 (Dec. 16, 2010).

<sup>91</sup> See text accompany note 95 *infra*.

<sup>92</sup> Kaplow, *supra* note 12, at 562.

<sup>93</sup> Kaplow *supra* note 12, at 571. The value of advice includes both the benefit of undertaking acts from which affected parties would have avoided without information and avoiding those not permitted which they would have undertaken without the information, in each case weighted by the likelihood of occurrence. *Id.*

<sup>94</sup> Kaplow, *supra* note 12, at 569.

application of a standard to their particular situations as well as how they perceive the likelihood and burden of possible sanctions.

The community of organizations exempt under section 501(c)(3) is diverse and numerous. The National Center for Charitable Statistics (“NCCS”) gives the number of all section 501(c)(3) organizations, both public charities and private foundations, as 1,441,406 as of 2010.<sup>95</sup> Most of this information is based on organizations that file the Form 990, the annual information return required for most organizations exempt under section 501(c), although it includes numbers for non-reporting organizations. The number also includes 278,772 churches, based on the website of American Church Lists in 2004, only about half of which have filed a 1023 application for exemption form with the IRS.<sup>96</sup> As note earlier, this large number of entities subject to the campaign intervention prohibition suggests that the IRS develop rules, at least for common situations, rather than rely on standards.

The NCCS approximated the number of section 501(c)(3) not reporting or not required to file Form 990 because they normally have less than \$25,000 in gross receipts at 691,008 in 2009.<sup>97</sup> That is, 43% of all organizations exempt under section 501(c)(3) and more than 68% of public charities were churches or normally had annual gross receipts of less than \$25,000. Another recent report states that 41 percent of returns filed by section 501(c)(3) organizations were filed by organizations with assets of less than \$100,000.<sup>98</sup>

Other data further emphasize the large percentage of tax-exempt organizations that are very small. The Pension Protection Act of 2006 mandated that organizations with gross receipts less than \$25,000 file (other than churches) a very short new Form 990, known as the 990-N or e-Postcard.<sup>99</sup> The deadline to file this form was May 17, 2010, although the IRS later extended

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<sup>95</sup> National Center for Charitable Statistics, Quick Facts About Nonprofits - Nonprofit Organizations *available at* <http://nccs.urban.org/statistics/quickfacts.cfm>. The 1,441,406 section 501(c) organizations include 1,046,719 public charities, 115,915 private foundations, and 278,772 congregations.

<sup>96</sup> Churches are required to file neither Form 1023, the application for exemption, nor Form 990, the Annual Information Return, required of other section 501(c)(3) organizations. See sec. 508(c)(1)(A); sec. 6033(a)(3)(A)(i).

<sup>97</sup> National Center for Charitable Statistics, *supra* note 95.

<sup>98</sup> Paul Arnsberger and Mike Graham, *Charities, Social Clubs, and Other Tax-Exempt Organizations, 2007*, in Fall, 2010 Statistics of Income Bulletin, *available at* <http://www.irs.gov/pub/irs-soi/07eocharteobull.pdf>.

<sup>99</sup> P.L. 109-280, sec. 1223(a), codified as sec. 6033(i). The IRS has increased the limits for filing this short form for any tax year beginning after December 31, 2009 to section 501(c)(3) to any organization that normally has gross

the deadline to October 15, 2010.<sup>100</sup> This requirement reaches beyond section 501(c)(3) organizations subject to the campaign intervention prohibition. What is important for our purposes is that the National Center for Charitable Statistics in a 2010 study of this new requirement, gave as the total number of registered 501(c) organizations as 1,441,406,<sup>101</sup> and the number of organizations required to file the e-Postcard as 714,379.<sup>102</sup> That is, of all organizations registered under section 501(c), those with gross receipts normally under \$25,000 are more than 45%.<sup>103</sup> If the ratio of organizations exempt under section 501(c)(3) to organizations exempt under provisions of section 501(c) in 2010 is the same as that for 2009, more than 70%, or more than 500,000, of these very small organizations will be currently exempt under section 501(c)(3).

Thus, a large percentage and number of organizations exempt under section 501(c)(3) and thus subject to the campaign intervention prohibition are very small and are unlikely to devote scarce resources to engage professionals to help them interpret the current standards that the IRS uses to interpret and apply the prohibition.<sup>104</sup> Kaplow reminds us that advice about a standard is more difficult and expensive than advice about a rule. “Because a standard requires a prediction of how an enforcement authority will decide questions that are already answered in the case of a rule, advice about a standard is more costly.”<sup>105</sup> Thus, even 501(c)(3) entities that are not so small as to be subject to the 990-N filing, but which decide that they must marshal limited resources for their exempt purposes may choose not to become as well informed

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receipts of \$50,000 or less. See *IRS Issues Guidance Relieving Some Small Organizations of Information Reporting*, 2011 TNT 10-6 (Jan. 14, 2011).

<sup>100</sup> *IRS Releases FAQs on One-Time Filing Relief Program for Small Charities*, 2010 TNT 167-47 (Aug. 10, 2010). <http://www.irs.gov/pub/irs-pdf/p4839b.pdf>

<sup>101</sup> This number includes non-501(c)(3)'s. See National Center for Charitable Statistics, *supra* note 95.

<sup>102</sup> Amy Blackwood and Katie L. Roeger, *Here Today, Gone Tomorrow: A Look at Organizations That May Have Their Tax-Exempt Status Revoked*, Urban Institute, National Center for Charitable Statistics (July 8, 2010) at 1 available at <http://www.urban.org/uploadedpdf/412135-tax-exempt-status.pdf>. The 2010 Report from the IRS Director, Exempt Organizations reported that 335,952 Form 990-Ns had been filed by October 15, 2010. Exempt Organizations 2010 Report, *supra* note 51, at 9.

<sup>103</sup> The largest percentage (26%) of Form 990-N filers are in the human services subsector – homeless shelters, soup kitchens, senior centers, meals on wheels; the next largest group (22%) is in the public and societal benefit subsectors, such as civil rights groups, neighborhood block associations. In contrast, health organizations and human service organizations tend to be larger. See Katie L. Roeger, *Small Nonprofit Organizations: A Profile of Form 990-N Filers*, Urban Institute, Center on Nonprofits and Philanthropy and Charting Civil Society (Aug. 2010), available at <http://www.urban.org/uploadedpdf/412197-nonprofit-form990-profile.pdf>.

<sup>104</sup> It may be that not all categories of section 501(c)(3) organizations are equally likely to engage in behavior that calls into issue the campaign intervention prohibition. See Colinvaux, *supra* note 26.

<sup>105</sup> Kaplow, *supra* note 12, at 569.

regarding standards as they would a rule. Furthermore, in learning about the content of the law, they are likely to look to sources other than professional advisors.

The IRS, recognizing this problem, has worked to educate section 501(c)(3) organizations and others about the campaign intervention prohibition. After the 2004 and 2006 PACI, the IRS published a fact sheet with detailed examples of the types of activities the IRS investigated during the 2004 election cycle and followed this fact sheet with Rev. Rul. 2007-41 and updated its webpage.<sup>106</sup> As part of the 2008 PACI, the IRS wrote letters to the national political party committees explaining the prohibition, published a letter in the Federal Election Commission's monthly newsletter asking candidates to ensure that their contacts with charitable organizations do not jeopardize the entity's exemption, issued a new release reminding charities and churches of the ban, and made public a memorandum from the Director, Exempt Organizations, Examinations describing the 2008 PACI.<sup>107</sup> The IRS has a number of resources on its webpage addressing the prohibition, including FAQs.<sup>108</sup> It has published A Tax Guide for Churches and Religious Organizations, which includes a number of examples involving the prohibition.<sup>109</sup>

For all these admirable attempts, however, the value of this guidance is limited by the fact that the IRS is trying to explain and enforce a standard, namely, that violations of the campaign intervention depend on facts and circumstances. For example, the FAQs include the question of "whether an organization can state its position on public policy issues the candidates for public office divide on." It answers:

An organization may take position on public policy issues, including issues that divide candidates in an election for public office so long as the message does not in any way favor or oppose a candidate. Be aware that the message does not need to identify the candidate by name to be prohibited political activity. A message that shows a picture of a

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<sup>106</sup> See *TIGTA Says Further Improvements to Exempt Orgs Outreach Possible*, 2008 TNT 127-30 (July 30, 2008).

<sup>107</sup> See IRS, *Political Compliance Initiative (2008)*, available at <http://www.irs.gov/charities/charitable/article/0,,id=181565,00.html>

<sup>108</sup> See IRS, *Political Campaign Intervention by 501(c)(3) Organizations – Educating Exempt Organizations*, available at <http://www.irs.gov/charities/charitable/article/0,,id=179750,00.html>; <http://www.irs.gov/charities/charitable/article/0,,id=179432,00.html>.

<sup>109</sup> See IRS, *Tax Guide for Churches and Religious Organizations*, available at <http://www.irs.gov/pub/irs-pdf/p1828.pdf>.

candidate, refers to a candidate's political party affiliations, or other distinctive features of a candidate's platform or biography may result in prohibited political activity.<sup>110</sup>

Such an answer gives little guidance as to what will constitute favoring or opposing a candidate or even what are distinctive features of a candidate's platform on the question that is the very topic of the question. Unlike Revenue Ruling 2007-41, it makes no mention of past and continuing discussion of the public policy issue by the organization as a factor, introducing tension between official and unofficial IRS guidance.

Other tax-exempt organizations also offer guidance to their own and other section 501(c)(3) organizations. To name just two as examples, both the United States Conference of Catholic Bishops,<sup>111</sup> and the American Library Association maintain guidance regarding the prohibition on their webpages.<sup>112</sup> Guidance as to what is permissible is also important. As Kaplow observes, legal knowledge may also cause those subject to a legal command to engage in conduct that they had mistakenly thought was forbidden or subject them to sanctions they thought severe but are in fact quite minor.<sup>113</sup> The Alliance for Justice is one of several organizations that has been active in explaining to charities the kind of activities that the campaign intervention prohibition leaves them free to undertake.<sup>114</sup>

Nonetheless, the IRS position that violation of the prohibition is a question of facts and circumstances limits the guidance any organization can provide. A standard is unlikely to provide the answers small organizations, those that do not have the luxury of hiring professionals for tax advice, need in reaching a conclusion regarding the application of the law to a particular fact pattern, particularly an unusual one. In contrast to the implications of the low level of enforcement, the considerations of both the total number of affected entities and the number of very small entities to which the prohibition applies suggest that the IRS and Treasury should develop rules rather than rely on standards. In addition, the light sanctions the IRS has imposed

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<sup>110</sup> IRS, *Frequently Asked Questions about the Ban on Political Campaign Intervention by 501(c)(3) Organizations: Organization Position on Issues*, available at <http://www.irs.gov/charities/charitable/article/0,,id=179462,00.html>

<sup>111</sup> See United States Conference of Catholic Bishops, *2007 Political Activity Guidelines for Catholic Organizations*, available at <http://www.usccb.org/ogc/guidelines.shtml>

<sup>112</sup> See American Library Association, *Election Year Do's and Don'ts*, available at <http://www.ala.org/ala/aboutala/governance/legalguidelines/electiondosanddonts/electionyear.cfm>

<sup>113</sup> Kaplow, *supra* note 12, at 571.

<sup>114</sup> See Alliance for Justice, *Nonprofit and Foundation Advocacy*, at <http://www.afj.org/for-nonprofits-foundations/>.

for at least the first identified violation of the prohibition, as the PACI results indicate, may further undermine the incentive of affected entities to learn to parse the meaning of a standard. For these reasons, a rule may increase compliance. Thus, the nature of the community affected by the campaign intervention prohibition calls for tax authorities to invest the resources to develop a set of rules rather than standards regarding the prohibition.

Kaplow considers the value a party puts on conduct from which it is deterred or permitted as the result of a legal command within his stage 2.<sup>115</sup> In the case of the campaign intervention prohibition, the value a charity places on political intervention will be closely related to its own norms, and I will discuss issues related to norms, both of the affected charities and the IRS, which I believe bear on the decision between a standard and a rule, below.

## V. Applicable Norms

Kaplow states that the quality of legal command can be understood as “reflecting how closely it conforms to underlying norms,”<sup>116</sup> and throughout his article urges attention to whether a rule or a standard is more likely to motivate behavior consistent with the underlying norm. For example, he writes that if individuals will become better informed under a rule than under a standard, their behavior will be more in accord with legal norms,<sup>117</sup> even though “it is usually said that standards result in more precise application of underlying norms because they can be applied to the particular facts of a case.”<sup>118</sup> He acknowledges but does not discuss in any detail the impact of different possible legal norms.<sup>119</sup>

In particular, nowhere does he discuss explicitly the case in which the decisionmaker and the affected parties may have differing beliefs about underlying norms and the effect of such a scenario on the choice between rules and standards. Yet, because standards give less *ex ante* content to a legal command, those subject to a standard (or their advisors) have more freedom to

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<sup>115</sup> Kaplow, *supra* note 12, at 571.

<sup>116</sup> Kaplow, *supra* note 12, at 579 n.2.

<sup>117</sup> Kaplow, *supra* 12, at 575.

<sup>118</sup> *Id.* at 622.

<sup>119</sup> For example, Kaplow refers to questions of which norms are appropriate at *id.*, 582 n. 62 (whether considering only safety and time or also energy conservation in designing laws governing driving) and 594 n. 98 (referring to Prof. Frederick Schauer’s distinction between a decisionmaker consulting a single background justification or all possible justificatory norms).

interpret the command. In so doing, we can expect them to bring their understanding of the underlying norms to bear. If those charged with carrying out the legal command and those subject to it come with different understandings of the underlying norms, the two groups may interpret a standard in very different ways, complicating education and compliance.

As Russell Korobkin explains in his behavioral analysis of rules and standards,<sup>120</sup> in the case of a standard, two competing behavioral biases come into play. On one hand, the general tendency toward risk aversion, the reluctance to take a position with an uncertain payoff, may cause some affected parties to unknowingly overcomply with the law. On the other hand, the self-serving bias, the phenomenon that individuals are likely to interpret ambiguous information in ways that resound to their benefit, is also present. The impact of the self-serving bias may mean that unknowing violations of the law “may be more prevalent than previously thought.”<sup>121</sup>

A system of factors, as the IRS has provided for many iterations of the campaign intervention prohibition, allows those affected “to weigh each factor as it chooses,”<sup>122</sup> and the self-serving bias can be expected to lead to greater weighing of factors that favor the affected entity. That is, standards give discretion to not only to administrators, as many have observed,<sup>123</sup> but also to the affected community. A rule, in contrast, leaves less room for ex ante interpretation by those subject to the legal command by recourse to underlying norms. Cass Sunstein puts it succinctly, “By settling cases in advance, rules . . . make it unnecessary and even illegitimate to return to first principles.”<sup>124</sup>

Thus, especially when understanding of underlying norms by affected parties and administrators differ, a rule rather than a standard may promote greater compliance with the legal command. Different understandings of underlying norms is, I believe, very much the case for the campaign intervention prohibition, both because of lack of Congressional explanation of the

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<sup>120</sup> Russell B. Korobkin, *Behavioral Analysis and Legal Form: Rules and Standards Revisited*, 79 OR. L. REV. 23 (2000).

<sup>121</sup> *Id.* at 46. He notes that “the self-serving bias is less problematic in a rules regime” and that “the self-serving bias suggests that standards will chill less desirable behavior than otherwise would be expected.” *Id.* But see Guinane, *supra* note 10, at n. 152 (reporting that in one survey, 43% of those 501(c)(3) organizations surveyed incorrectly believed they could not host a candidate debate or forum).

<sup>122</sup> Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953, 1012 (1995).

<sup>123</sup> See, e.g. *id.* at 960-61; Ellen P. Aprill, *Tax Shelters, Tax Law, and Morality: Codifying Judicial Doctrines*, 54 S.M.U. L. REV. 9, 22-33 (2001).

<sup>124</sup> Sunstein, *supra* note 122, at 975.

purpose of the provision and because the administrative agency and section 501(c)(3) organizations diverge as to the role of the First Amendment as an underlying norm.

Statements of Congressional purpose can guide both administrators and affected parties in understanding the reach and meaning of a legal command.<sup>125</sup> Congress, however, has not provided guidance in the form of legislative history as to its purpose in adopting the campaign intervention prohibition. Then-Senator Lyndon Johnson inserted the campaign intervention prohibition as a floor amendment to legislation that produced the Internal Revenue Code of 1954;<sup>126</sup> the applicable statutory provisions at the time limited only lobbying activity.

There is no legislative history explaining the reasoning of Congress in first adopting the provision.<sup>127</sup> Many who have examined the legislative record have concluded that its motive was simply political animus: Senator Johnson was responding to attacks on him by conservative charities in his recent reelection campaign.<sup>128</sup> As others have documented,<sup>129</sup> however, Johnson's floor amendment came after months of House investigation of the political activities of charitable organizations. The first of two committees conducting this investigation was charged with determining "whether foundations have been infiltrated by communists,"<sup>130</sup> the second with determining whether charitable organizations are "using their resources for un-American and

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<sup>125</sup> See, e.g., Peter Strauss, *When the Judge Is Not the Primary Official with Responsibility to Read: Agency Interpretation and the Problem of Legislative History*, 66 CHI.-KENT L. REV. 321 (1990).

<sup>126</sup> 100 Cong. Rec. 9128 (1954).

<sup>127</sup> Johnson stated:

Mr. President, this amendment seeks to extend the provisions of section 501 of the House bill, denying tax-exempt status to not only those people who influence legislation but also to those who intervene in any political campaign on behalf of any candidate for any public office. I have discussed the matter with the chairman of the committee, the minority ranking member of the committee, and several other members of the committee, and I understand that the amendment is acceptable to them. I hope the chairman will take it to conference, and that it will be included in the final bill which Congress passes.

*Id.* As others have noted, this statement seems to assume that all lobbying by section 501(c)(3) organizations is prohibited, while in fact lobbying at the time was permitted so long as it was not substantial. See 26, *supra* note ; Judith E. Kindell and John Francis Reilly, *Election Year Issues*, 2002 EO CPE Text 337, available at <http://www.irs.gov/pub/irs-tege/eotopici02.pdf>.

<sup>128</sup> See e.g., Oliver A. Houck, *On the Limits of Charity: Lobbying, Litigation, and Electoral Politics by Charitable Organizations under the Internal Revenue Code and Related Laws*, 69 BROOK. L. REV. 1, 16-23 (2003); Patrick L. O'Daniel, *More Honored in the Breach: A Historical Perspective of the Permeable IRS Prohibition on Campaigning by Churches*, 42 B. C. L. REV. 733, 768 (2001); BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* § 23.1 (9<sup>th</sup> ed. 2007).

<sup>129</sup> See Colinviaux, *supra* note 26; Ann M. Murphy, *Campaign Signs and the Collection Plate – Never the Twain Shall Meet?* 1 PITTSBURGH TAX REV. 35 (2003), Kindell and Reilly, *supra* note 127, at 448-451.

<sup>130</sup> Murphy, *supra* note 129, at 49.

subversive activities.”<sup>131</sup> The second committee recommended that charities be forbidden to engage in both lobbying and political campaigns, “leaving it to the courts to apply the maxim of *de minimis no curat lex*.”<sup>132</sup> Based on these facts, some have asserted that Johnson sought to head off an even more restrictive rule.<sup>133</sup> Even if such is the case, the legislative record at the time of the prohibition’s adoption does not offer the purpose of or the reasons for the rule.

Legislative history from 1987 explains that the ban “reflects a Congressional policy that the U.S. Treasury should be neutral in political affairs.”<sup>134</sup> The fact that a number of other categories of tax-exempt organization are permitted to engage in political campaign intervention undercuts this rationale. These other categories of tax-exempt organizations, however, are not eligible to receive tax-deductible contributions. Thus, a more persuasive justification for the prohibition is that Congress did not wish to allow tax-deductible contributions to be used for political campaign intervention, or, in the oft-quoted words of Judge Learned Hand, political controversies “must be conducted without public subvention; the Treasury stands aside from them.”<sup>135</sup> Even if accepted, such a justification gives little help either to the IRS in determining how to give content to and administer the rule or to others trying to sort out a facts and circumstances test in light of the underlying principles it is intended to advance. It may, however, suggest that the campaign intervention prohibition should be interpreted broadly.

Whatever the policy reasons for the campaign intervention prohibition, its application is complicated further by the First Amendment protection that many affected parties assert. What matters for an administrator choosing between a rule and a standard under Kaplow’s analysis is not whether those making such constitutional arguments are correct,<sup>136</sup> but only that they believe the arguments to be so and base their behavior on them.

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<sup>131</sup> H.R. Rep. No. 83-2681, at 1 (1954).

<sup>132</sup> *Id.* at 219.

<sup>133</sup> Kindell and Reilly, *supra* note 127, at 448-51.

<sup>134</sup> H.R. Rep. No. 100-391 (II), at 1625, 1627 (1987). See Ellen P. Aprill, *Churches, Politics, and the Charitable Contribution Deduction*, 42 B.C. L. REV. 843, 843-44 (2001).

<sup>135</sup> *Slee v. Comm’r*, 42 F.2d 184, 185 (2d Cir. 1930). *Regan v. Taxation with Representation*, 461 U.S. 540, 544 (1983), upholds as constitutional limits on lobbying by section 501(c)(3) organizations on the basis that there is no duty to subsidize First Amendment activity. It is generally assumed that the same reasoning applies to the campaign intervention prohibition. See Aprill, *supra* note 134.

<sup>136</sup> That is, I am not making a rights-based argument.

A number of church groups believe that any formulation of the prohibition violates their constitutionally guaranteed free exercise of religion. The Alliance Defense Fund (“ADF”) has now sponsored three annual Pulpit Freedom Sundays in late September.<sup>137</sup> Ministers participating in Pulpit Freedom Sunday preach about how scripture applies to every area of life, including, if they choose, candidates for election. The ADF has organized Pulpit Freedom Sunday in hopes that the IRS will revoke the exemption of at least some participating churches so that the ADF can challenge the constitutionality of the political campaign intervention prohibition.<sup>138</sup> The ADF reports that approximately 100 churches from 30 states as compared to eighty-four churches from thirty states participated in Pulpit Freedom Sunday in 2009 and “nearly three dozen” in 2008, although it is not clear how many ministers engaged in political campaign intervention by endorsing or opposing candidates for public office.<sup>139</sup> Those that believe that any limitation on the speech of churches violates their constitutional free exercise rights will not care whether the legal command is embodied in a rule or a standard.<sup>140</sup> That is, they question the statutory legal command and not just the IRS efforts to interpret and enforce the command.

Others take the position that speech regarding political candidates benefits from First Amendment protection because it is core First Amendment speech. The Catholic Answers complaint took just such a position, challenging the applicable regulations on First Amendment grounds. The IRS reliance on vague standards, these critics of the current approach argue, chills section 501(c)(3) organizations from expressing their views, and undermine freedom of association.<sup>141</sup> Such a view of the First Amendment calls for reading the legal commands

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<sup>137</sup> See ADF News Release, *Participants in Pulpit Freedom Sunday increase for third year*, available at <http://www.adfmedia.org/News/PRDetail/4361>.

<sup>138</sup> See Bob Unruh, *See What the IRS Has Stopped in Its Tracks: Pulpit Freedom Sunday Has Church Leaders Challenge Government Censorship*, WorldNet Daily (Sept. 23, 2010), available at <http://www.wnd.com/index.php?fa=PAGE.view&pageId=207025>.

<sup>139</sup> *Id.* The ADF initiative may account for the larger number of candidates being endorsed during normal church services in the 2008 PACI summary data. See *supra* note 83.

<sup>140</sup> As Kaplow puts it, in considering the category of individuals not becoming informed either under a rule or under a standard,

Because individual do not become informed under either formulation of the law, information costs are not incurred. Moreover, uniformed individuals’ behavior does not depend on whether a rule or standard prevails, so the benefits and harms of individuals’ acts will be the same. Thus in the case, whether a rule or standard is preferable will depend solely on the differences in promulgation and enforcement costs.

Kaplow, *supra* note 12, at 572.

<sup>141</sup> See Kay Guinane, *supra* note 10.

narrowly, as applying to only limited types of speech. Such a view looks especially to *Wisconsin Right to Life*, where Chief Justice Roberts wrote that First Amendment standards “must give the benefit of any doubt to protecting rather than stifling speech.”<sup>142</sup> Another recent article argues that the vagueness of current IRS standards violates both the due process clause and the First Amendment.<sup>143</sup>

Again, the question is not whether those that endorse these constitutional arguments are right.<sup>144</sup> From an administrator’s point of view what matters is whether those subject to a legal command believe them to be right in such a way as to influence compliance and, in particular, interpretation of a standard.

The IRS itself also recognizes that the campaign intervention prohibition carries with it important First Amendment considerations. The Report on the 2004 PACI, for example, states as one of the challenges to the IRS in enforcing and educating organizations about the campaign intervention the fact that “[t]he activities that give rise to questions of political campaign intervention also raise legitimate concerns regarding freedom of speech and religious expression.”<sup>145</sup> At the same time, it is generally the duty of administrative agencies to execute the legal commands assigned to them without consideration of the constitutionality of the legal commands they enforce. “[A]djudication of the constitutionality of congressional enactments has generally been thought beyond the jurisdiction of administrative agencies.”<sup>146</sup>

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<sup>142</sup> Federal Election Commission v. Wisconsin Right to Life, 551 U.S. 449, 469 (2007) (citing *New York Times v. Sullivan*, 376 U.S. 254, 269-70 (1964)). The majority in *Citizens United v. FEC* also cited this language, 130 S. Ct. 876, 891 (2010).

<sup>143</sup> James Bopp, Jr. and Zachary S. Kester, *supra* note 10.

<sup>144</sup> Of course, if those making First Amendment arguments are correct on the void for vagueness and chilling of protected speech arguments, the IRS will have no choice but to write rules to carry out the campaign intervention prohibition.

<sup>145</sup> 2004 PACI Report, *supra* note 70.

<sup>146</sup> *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 215 (1994), quoting *Johnson v. Robison*, 415 U.S. at 368, quoting *Oestereich v. Selective Serv. System Local Bd. No. 11*, 393 U.S. at 242 (Harlan, J., concurring in result). The Court goes on to observe, “This rule is not mandatory, however.” *Id.* See also Harold J. Bruff, *Specialized Courts in Administrative Law*, 43 Admin. L. Rev. 329, 361-62 (1991); Student Author, *The Authority of Administrative Agencies to Consider the Constitutionality of Statutes*, 90 Harv. L. Rev. 1682, nn. 1-3 (1977). However, as Bernard Bell has observed, “Some agencies have jurisdiction over issues which clearly implicate constitutional concerns, and thus Congress clearly contemplates that they may have to address constitutional principles. Congress could not be expected to address all such tensions between policy goals and constitutional principles in advance. The Federal Communications Commission is a prime example of such an agency.” Bernard

The issue on which this piece focuses is not adjudicating the constitutionality of a statute, but promulgating administrative directives in a way that best effects compliance. When a large percentage of those running and advising affected organizations believe that the First Amendment constrains the campaign intervention prohibition, promulgating administrative guidance as standards is likely to decrease compliance. On one hand, a standard without specific criteria allows affected parties to read it in terms of their own norms, rather than those the IRS assumes. For example, when the IRS cites a variety of factors, affected organizations will have a normative basis for giving the most weight to factors in their favor. On the other hand, misunderstanding of standards may prevent organizations from engaging in permitted activity.<sup>147</sup>

The belief of affected parties regarding underlying norms cannot dictate administrative action. If such were the case, affected parties could unduly influence the content of legal commands. Nonetheless, administrators wishing to encourage compliance appropriately take into account the norms of the regulated entities in deciding between rules and standards. Given the beliefs of many of the affected parties regarding the First Amendment, standards will not accurately constrain behavior. Moreover, many affected by the legal command believe that underlying First Amendment norms require the specificity of rules rather than the uncertainty of standards. That the IRS itself recognizes the role of the First Amendment also argues in favor of the IRS adopting rules rather than standards.

## VI. Arguments against Rules

Thus far, consideration of the large number of affected parties, the likelihood that many affected parties will not seek legal advice regarding compliance with the legal command, and the differing norms animating the administrative agency administering the legal command and the affected parties would all seem to argue in favor of rules rather than standards. Arguments against rules, however, cannot be ignored.

Kaplow addresses the frequent complaint against rules that they are under or over inclusive. They fail to cover some situations that the legal command should encompass and may

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Bell, *Enacting and Interpreting Statutes in the Constitution's Shadow: Symposium Introduction*, 32 DAYTON L. REV. 307, 311 n. 22 (2007).

<sup>147</sup> Guinane, *supra* note 10, at n. 152 (reporting that in one survey, 43% of those 501(c)(3) organizations surveyed incorrectly believed they could not host a candidate debate or forum).

catch some that they should not. Often the complaint against rules takes the form of describing rules as too simple, while standards are more complex in application because they inherently encompass more relevant considerations and thus achieve a better fit with underlying norms.<sup>148</sup> Kaplow urges that considerations of simplicity versus complexity be separated from considerations of ex ante versus ex post that underlie the rules/standard distinction. Too often, he contends, these categories are conflated and a simple rule is compared to a complex standard. At the same time, however, he acknowledges, “When one makes a single pronouncement that will govern many (perhaps millions) of cases, it is worthwhile to undertake greater investigations into the relevance of additional factors and to expend more effort fine-tuning the weight accorded to each. Thus, when rules are to be applicable to frequent behavior with recurring characteristics, there is a systematic tendency for rule systems to be more complex than the content that would actually be given to standards covering the same activity.”<sup>149</sup> When rules are complex, learning their content will impose a cost on the affected parties in way that, in at least some cases, standards will not.

As David Weisbach has argued in partial rebuttal of Kaplow, standards can allow the tax law to be simpler than a system of only rules.<sup>150</sup> Kaplow, like others, has observed that it is difficult to draft rules to cover uncommon situations. Weissbach argues that, in the case of tax law, it is particularly important to tax uncommon transactions appropriately because taxpayers will make them common as they discover how to take advantage of them.<sup>151</sup> Thus, infrequent transactions must be addressed in the area of tax. To do so in rules, however, will make the rules too complex, especially given interaction among tax rules.<sup>152</sup> Moreover, rules may often be inaccurate at their borders, and thus complex rules will create additional opportunities for planning. Standards, in contrast, do not have to anticipate each and every situation, every combination and permutation that might arise in the future. Weisbach thus concludes that an

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<sup>148</sup> Kaplow, *supra* note 12, at 589-90.

<sup>149</sup> Kaplow, *supra* note 12, at 595.

<sup>150</sup> David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860 (1999).

<sup>151</sup> *Id.* at 869.

<sup>152</sup> *Id.*

anti-abuse rule may well be appropriate when they are more certain than other approaches to solving the intersection of rules, standards and complexity.<sup>153</sup>

The problematic situations that Weissbach identifies do not seem to apply with great weight to the campaign intervention prohibition. It interacts with few provisions. Any set of rules defining campaign intervention would need to consider the impact of limitation on section 501(c)(3) organization's ability to lobby; that is, because lobbying by section 501(c)(3) organizations is permitted to some extent while political intervention is prohibited, it is important to distinguish the two activities. Rules defining campaign intervention will also need to coordinate with a definition of campaign intervention for other organizations exempt under section 501(c) that are permitted to engage in campaign intervention so long as it is not their primary activity, such as 501(c)(4) social welfare organizations, section 501(c)(5) labor organizations, and section 501(c)(6) trade associations. Finally, any definition of campaign intervention for purposes of section 501(c) must also be coordinated with section 527, which applies to political organizations, namely those organizations with a primary purpose of campaign intervention.<sup>154</sup> That is, we need to consider all definitions of political activity for purposes of the Internal Revenue Code. Defining campaign intervention is not, however, the kind of scenario that Weissbach posits, in which a number of provisions can shape a corporate or partnership transaction.

Nonetheless, a greater reliance on rules to give content to the campaign intervention does raise important concerns. The need to cover all likely possibilities may produce a complex set of rules. A complex set of rules, like a standard, may discourage those affected by the rules, especially smaller organizations, from seeking legal advice. Any set of rules is likely to be under-inclusive to some extent, a state of affairs that is likely to concern the IRS if it views legislative history as directing broad enforcement of the prohibition. Sophisticated organizations and their advisors would be able to take advantage of rules by staying within the letter of the rules while violating their spirit with impunity. Any set of rules is likely to be over-inclusive in other regards, a state of affairs of great concern to those members of the affected community

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<sup>153</sup> *Id.* at 879.

<sup>154</sup> Section 527(e)(1). See Aprill, *Regulating the Political Speech*, *supra* note 26.

who view the First Amendment and the accompanying need not to chill protected speech as an underlying norm to any regulation of speech.

There is also an argument that the uncertainty engendered by a set of standards rather than rules will lead to greater compliance by the affected community, a result that IRS might be expected to embrace. Under a standard, such as the set of factors currently in use, the limits of the campaign intervention prohibition are unclear. Risk adverse charities could be expected to avoid any activity that might run afoul of the prohibition. Thus, compliance with the prohibition will be achieved, albeit at the cost of some over-inclusion. A number of scholars have in fact urged that tax administrators use strategic uncertainty, strategically withholding guidance, as a tool for tax compliance.<sup>155</sup> But as Leigh Osofosky has explained, if taxpayers perceive the lack of guidance as ambiguity regarding a tax outcome, “taxpayers with a low chance of success on the merits would be more likely to claim the tax benefits, whereas taxpayers with a high chance of success on the merits would have the opposite inclination.”<sup>156</sup>

Thus, although developing a set of rules raises a number of concern regarding over and under inclusiveness, such is also the case with a standard, with some organizations treating the standard as over inclusive and others seeing it as under inclusive, depending on their appetite for risk. Aggressive taxpayers may become more aggressive, and conservative taxpayers more conservative, in the latter case such much so that they fail to undertake permitted activities.<sup>157</sup>

## VII. What Should the IRS Do?

Kaplow’s calculus urges that those deciding whether to undertake the burdensome process of promulgating a rule consider both the level of enforcement and the nature of the affected parties, in particular whether and how they would go about understanding a standard. The presence of many affected organizations unable to hire expert advice regarding the political campaign intervention prohibition argues for a rule. The low level of enforcement of the

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<sup>155</sup> See Leigh Osofsky, *The Case Against Strategic Tax Law Uncertainty*, 64 TAX. L. REV. 501, 501-2 N.4 (2011), for a list of such scholars.

<sup>156</sup> *Id.* at 504.

<sup>157</sup> See note 147 *supra* (reporting that 43% of section 501(c)(3) organizations surveyed incorrectly believed they could not host a candidate forum or debate; *cf.* text at notes 120-121 (Korobkin’s comparison of weight of risk aversion and self-serving bias.)

political campaign intervention argues, at least at first look, for a standard. But Kaplow also suggests that if many are affected by the legal command, a rule could be worthwhile even when enforcement is low. Moreover, the likelihood that many of the regulated parties see norms underlying the prohibition differently from the IRS suggests that use of standards undermines compliance. All of these considerations lead to the conclusion that the IRS should promulgate more rules in connection with the campaign intervention prohibition. Considerations regarding the potential complexity and the potential for both under and over inclusiveness, however, raise the question of whether a thorough rule based regime or something less than that would be more desirable.

One way “of obtaining the benefits without some of the costs” is to make use of standards with safe harbors.<sup>158</sup> In 2005, I drafted and sent to the IRS and Treasury a set of four possible safe harbors.<sup>159</sup> One of the suggested safe harbors, for example, would have protected remarks by a speaker, whether or not an official of the organization, whose remarks include the statement that the speaker is speaking only for him or herself and not telling the audience how to vote. Such a safe harbor would have overturned current IRS policy<sup>160</sup> and have provided an easy, perhaps too easy, means for permitting many communications currently forbidden under existing guidance.

The analysis undertaken in this article, however, leads to the conclusion that promulgating a more robust set of rules is appropriate and would lead to the greatest possible compliance with the law. Revenue Ruling 2007-41, for example, demonstrates there is a manageable set of categories of activities in which the political campaign intervention are most likely to arise. At the same time, the findings of the PACI over several election cycles show that there is a limited number of recurring types of violation. For all these reasons, I would now endorse an effort to go beyond framing a few safe harbors to urging development of a set of

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<sup>158</sup> Weisbach, *supra* note 150, at 876-877.

<sup>159</sup> *Loyola Professor Proposes Safe Harbors for Political Campaign Activity by 501(c)(3) Groups*, 2005 TNT 231-19 (Dec. 2, 2005). Gregory Colvin also at one time suggested a safe harbor. *See OMB Watch Seeks Bright-Line Definition of Prohibited Political Activity by Charities*, 2009 TNT 105-20 (June 4, 2009). As discussed in text at note 163 *infra*, he has now moved to suggesting a set of rules.

<sup>160</sup> Kindell and Reilly, *supra* note 127, at 364 (disclaimer that communication is made in speaker’s individual capacity “insufficient to avoid attribution of the endorsement to the organization” when endorsement made in organization’s publication or at official function).

rules. Such rules could well include safe harbors at various points, but I recommend a comprehensive effort to develop a fuller set of rules.<sup>161</sup>

One commentator has called upon the IRS and Treasury to use as a model for such a set of rules the regulations regarding the election available to section 501(c)(3) organizations to adopt an expenditure limit for lobbying activities under sections 501(h) and 4911,<sup>162</sup> and Gregory Colvin has undertaken the first iteration of such an effort.<sup>163</sup> According to Colvin, “Although the charitable lobbying regulations are lengthy, the interpretive detail and examples aid in sharply drawing the basic definitions and in sharply drawing a few safe harbor exceptions.” Moreover, they have “generated practically zero controversy” and various groups “provide handbooks and seminars to teach charities what they can and can’t do, with or without help from lawyers, to influence legislation.”<sup>164</sup>

I would urge some caution in relying on these regulations. For all their supposed success, very few section 501(c)(3) organizations choose to be subject to this elective regime, probably no more than 1-2%. It is difficult to know why such is the case. It may derive from their length or their complexity. It might also be traced to the fact that the most any organization can spend on lobbying under the elective regime is \$1,000,000.<sup>165</sup> Nonetheless, this low level of adoption must give us pause in calling the regulations successful (and I speak as one who spent many hours working on these regulations as a staffer in Treasury’s Office of Tax Policy). If the complexity of the applicable set of rules is discouraging the adoption of the lobbying expenditure election, such a reaction stands as a caution in adopting a complex set of rules to define campaign intervention.

Previously in this piece, I have discussed First Amendment norms without accepting their validity. Should the IRS devote the considerable energies that developing a set of rules

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<sup>161</sup> To support its suggestion that the prohibition be repealed or circumscribed, the Senate Staff Report states that the current IRS facts and circumstances test is difficult to administer, but does not consider the possibility of the IRS and Treasury developing a set of more specific rules. See Senate Staff Report, *supra* note 26.

<sup>162</sup> Guiane, *supra* 10, at 170. See Treas. Reg. sec. 1.501(h), Treas. Reg. sec. 56.4911.

<sup>163</sup> Gregory L. Colvin, *Political Tax Law After Citizens United: A Time for Reform*, 66 EXEMPT ORG. TAX REV. 71 (2010).

<sup>164</sup> *Id.*

<sup>165</sup> A sliding scale sets lobbying expenditure limits under the elective regime, subject to the \$1,000,000 ceiling. An organization with a budget of \$17,000,000 or more will be subject to the \$1,000,000. See section 4911(c).

requires, prudence dictates that those writing the rules take heed of First Amendment concerns and the extent to which First Amendment standards developed in other areas of the law, particularly federal election law, may apply to the campaign intervention prohibition.<sup>166</sup> Thus, in drafting a set of rules for the political campaign intervention, Treasury and the IRS will face a difficult task in deciding how much to import First Amendment considerations developed in other areas of law. This difficult task compounds further the difficulties inherent in developing a coherent, easily applicable set of rules. But the consequences of reliance on standards in this area, even apart from constitutional concerns, call upon them to do so.<sup>167</sup>

## VIII. Conclusion

Critiques of the IRS approach to regulating the campaign activities of section 501(c)(3) organizations, like most other critiques of the IRS, generally take the point of view of the regulated entities to point out the defects in the IRS approach, in particular the difficulties taxpayers can face in complying with standards. In the case of the campaign intervention prohibition, the critique of current IRS standards in this area draws heavily on First Amendment jurisprudence, a more unusual approach for those taking the IRS to task. This article has approached the problem from yet another point of view. It attempts to address the issue from the agency's point of view in balancing its responsibilities in encouraging compliance and accurately identifying offenders. To do so, it has applied Kaplow's *Rules Versus Standards: An Economic Analysis*, which makes no assumptions about the inherent superiority of a rule or a standard. Application of the considerations identified by Kaplow - the low level of enforcement, the large number of affected parties, and the number of affected parties unlikely to seek legal advice - strongly suggests that rules will better regulate this area than standards, at least when the topic of

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<sup>166</sup> See Miriam Galston, *When Statutory Rights Collide: Will Wisconsin Right to Life and Citizens United Invalidate Federal Tax Regulation of Campaign Activity?* 12 U. PA. J. CON. L. 867 (2011). Aprill, *Regulating the Political Speech*, *supra* note 26. The Senate Staff Report suggests that "participate" or "intervene" be interpreted consistently with the federal election law. See Senate Staff Report, *supra* note 26. It seems to make the suggestion as legislative rather than a regulatory matter, but the IRS and Treasury could issue regulations to that effect, although such an interpretation would narrowly substantially the scope of the campaign intervention prohibition, since the Supreme Court has limited FEC regulation of campaign intervention to regulation of express advocacy or, in limited circumstances shortly before an election, its equivalent. See Galston *supra*.

<sup>167</sup> The possibility of legislative change, as recommended by the Senate Staff Report, could well give the IRS and Treasury pause in undertaking such a regulation project. I believe that legislative change is unlikely and that regulatory change such as those discussed here could reduce its likelihood further.

regulations affects both large and small section 501(c)(3) organizations.<sup>168</sup> Other considerations, such as the how affected parties may interpret standards and constitutional considerations that surround the prohibition, reinforce this conclusion. The IRS should undertake the difficult work of writing a set of rules for the campaign intervention prohibition.

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<sup>168</sup> That is, different considerations apply to the question of rules versus standards if the regulation is of areas likely to affect only those section 501(c)(3)'s with access to tax advisors, such as hospitals or private foundations.