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THE SECTION 527 OBSTACLE TO MEANINGFUL SECTION 501(c)(4) REGULATION

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THE SECTION 527 OBSTACLE TO MEANINGFUL SECTION 501(c)(4) REGULATION

*Ellen P. Aprill**

I. INTRODUCTION

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

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

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¹ I.R.C. § 501(c)(4); Fred Stokeld, *IRS Sparks Outrage with Admission It Mistreated Tea Party Groups*, TAX NOTES TODAY, May 13, 2013, 2013 TNT 92-3 (LEXIS).

² INSPECTOR GEN. FOR TAX ADMIN., DEP’T OF TREASURY, 2013-10-053, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW (2013), <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf>. I will use the term “political campaign intervention” to refer in general to this activity; I will limit the term “candidate-related political activity” introduced in the 2013 Proposed Regulation, to discussion of the 2013 Proposed Regulation. See Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

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

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

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

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

⁵ In contrast, in order to qualify as a tax-exempt charity under § 501(c)(3), an organization must not “participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.” I.R.C. § 501(c)(3).

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

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

⁸ INSPECTOR GEN. FOR TAX ADMIN., *supra* note 2, at 17.

⁹ TAXPAYER ADVOCATE SERVICE, I.R.S., SPECIAL REPORT TO CONGRESS: POLITICAL ACTIVITY AND THE RIGHTS OF APPLICANTS FOR TAX-EXEMPT STATUS 14–15 (2013).

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

The 2013 Proposed Regulation prompted a record number of comments on a proposed tax regulation—just under 170,000.¹² On May 22, 2014, the IRS announced that it and the Treasury Department would be making changes to the 2013 Proposed Regulation in light of the comments received.¹³ During an interview on June 18, 2014 with the Center for Public Integrity, the IRS Commissioner John Koskinen stated that he expected revised regulations to be ready in early 2015 and that they would address not only definitional issues, but also the amount of political campaign intervention permitted and to what organizations the rules would apply.¹⁴

¹⁰ Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

¹¹ *Id.*

¹² As of July 14, 2014, the exact number was 169,013. I do not claim to have read even a large percentage of the comments, but have tried to read many of the comments submitted from well-known organizations. Because this piece will emphasize the interaction of § 527 and § 501(c), I note that, in 2004, when the Federal Election Commission proposed a rule to treat § 527 organizations as political committees under the Federal Election Campaign Act in certain situations, it received more than 150,000 comments, a number in the same ballpark. See Richard Briffault, *The 527 Problem . . . and the Buckley Problem*, 73 GEO. WASH. L. REV. 949, 951 (2005). Ultimately, the FEC did not adopt such a rule. See Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

¹³ IRS Update on the Proposed New Regulation on 501(c)(4) Organizations, INTERNAL REVENUE SERV. (May 22, 2014), [http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501\(c\)\(4\)-Organizations](http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations).

¹⁴ See Julie Patel, *IRS Chief Promises Stricter Rules for ‘Dark Money’ Nonprofit Groups*, THE CTR. FOR PUB. INTEGRITY (Nov. 20, 2014), <http://www.publicintegrity.org/2014/06/18/14960/irs-chief-promises-stricter-rules-dark-money-nonprofit-groups>; David van den Berg, *New 501(c)(4) Regs Should Drop by Early 2015, Koskinen Says*, 143 TAX NOTES 1366, 1366 (2014). Section 501(c)(5) unions and § 501(c)(6) business leagues have already expressed objection to any extension to their categories. See Paul C. Barton, *Unions Say History Endorses Their Political Role*, TAX NOTES TODAY, Dec. 24, 2015, 2014 TNT 247-4 (LEXIS); Paul C. Barton, *Wider IRS Nonprofit Rules Likely to Anger Trade Groups, Congress*, 145 TAX NOTES 779, 779 (2014).

Although no revised regulation was issued in early 2015, the Office of Information and Regulatory Affairs of the Office of Management and Budget scheduled publication of a revised § 501(c)(4) proposed regulation for June 2015.¹⁵ On June 15, however, at the annual meeting of the AICPA Not-for-Profit Industry Conference, Ruth Madrigal, Attorney-Advisor in the Office of Tax Policy in the Department of the Treasury, discouraged expectation of a June release.¹⁶ *The New York Times* reported in mid-July 2015 that revised regulations will not be issued until after the 2016 election.¹⁷ Speaking to a House committee on July 23, 2015, the IRS Commissioner Koskinen confirmed that revised regulations would not be issued prior to the 2016 election.¹⁸ He explained to reporters after the hearing, “I don’t want people thinking we are trying to get these regs done so we can influence the election.”¹⁹ On October 27, 2015, Commissioner Koskinen stated at a Senate Finance Committee hearing that the IRS hopes to release new proposed regulations in early 2016.²⁰ However, the FY 2016 Omnibus Appropriations bill, passed by Congress and signed by the President in the middle of December, 2015, includes a provision prohibiting during fiscal year 2016 the use of any federally appropriated funds “to issue, revise, or finalize any regulation . . . relating to the standard which is used to determine whether an organization is operating exclusively for the promotion of social welfare for purposes of section 501(c)(4).”²¹

¹⁵ Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

¹⁶ See E-mail from Paul Streckfus, Editor, EO Tax Journal, to EO Tax Journal Subscribers (June 16, 2015, 01:57 EST) (on file with author).

¹⁷ Nicholas Confessore, *Nonprofit Group Tied to Rubio Raises Millions While Shielding Donors*, N.Y. TIMES, July 7, 2015, at A17; Eric Lichtblau, *I.R.S. Expected to Stand Aside as Nonprofits Increase Role in 2016 Race*, N.Y. TIMES, July 6, 2015, at A13.

¹⁸ Editorial, *The I.R.S. Gives up on ‘Dark Money,’* N.Y. TIMES, July 25, 2015, at SR8.

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

²⁰ Fred Stokel, *New (c)(4) Regs Could Come Early Next Year, Koskinen Says*, TAX NOTES TODAY, Oct. 28, 2015, 2015 TNT 208-5 (LEXIS).

²¹ Consolidates Appropriations Act, 2016, Pub. L. No. 114-113, Division E § 127 (2015).

To state a truism, regulation of politics inevitably becomes political. Even in the absence of the Tea Party controversy, developing regulations regarding what and how much political campaign intervention is permitted for tax-exempt entities would present a daunting issue for tax administrators. When the Treasury and the IRS do revise the 2013 Proposed Regulation, they are sure to face opposition and controversy from many sides, including members of Congress.²²

This paper argues that, despite their best efforts, the Treasury and the IRS will be unable to propose a regulation that will satisfy critics either on the left or on the right because of a structural issue—the existence and operation of § 527 of the Code, the provision defining, regulating, and taxing political organizations.²³ Section 527, in general, shields the “exempt function income” of political organizations from taxation. Exempt income is defined as contributions and other funds raised for political purposes.²⁴ However, any exempt organization that expends funds for an exempt function must pay tax on the lesser of its net investment income or the amount it spends on political campaign intervention.²⁵

In my view, regulation of political campaign intervention by § 501(c)(4) and other § 501(c) organizations cannot function well without establishing meaningful limits, and I believe that § 527 hamstring the IRS

²² Prior to Koskinen’s July 23 statement, Republican members of Congress sought to delay by legislation until at least 2018 any new regulation regarding the campaign intervention activities of § 501(c)(4) organizations. See S. 283, 114th Cong. (2015); H.R. 599, 114th Cong. (2015); Orrin G. Hatch, *IRS Should Reject Political Activity Proposal, Hatch Says*, TAX NOTES TODAY, Apr. 13, 2015, 2015 TNT 71-24 (LEXIS); Paul C. Barton, *Republicans Again Seek Delay in Rulemaking on Nonprofits*, 146 TAX NOTES 588, 588 (2015); Editorial, *Dark Money’s Deepening Power*, N.Y. TIMES, June 29, 2015, at A18.

²³ A political organization is defined as “a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purposes of directly or indirectly accepting contribution or making expenditures, or both, for an exempt function.” I.R.C. § 527(e)(1). As discussed *infra* notes 105–06, not all commentators agree with my conclusion regarding the interaction of these sections.

²⁴ I.R.C. § 527(e)(2). Although political campaign intervention under § 501(f) and exempt function differ in some details, I will treat the categories as identical and point out differences if and when relevant.

²⁵ *Id.* § 527(f).

in setting limits for such activity by § 501(c) organizations.²⁶ That is, I reluctantly agree with the point Commissioner Koskinen made when speaking to reporters on March 24, 2015: “The framework Congress has is you get to pick where you want to be. . . . If you spend, at this point, less than forty-nine percent of your money on politics, you can be a (c)(4) . . . if you want to spend all of your money on politics, or more than fifty percent of it, then Congress has provided [§ 527] as a place where you can land.”²⁷

In order to permit better and more consistent regulation of political campaign intervention, this paper proposes a number of changes to § 527, including moving responsibility for disclosure to the Federal Election Commission.²⁸ It further suggests that § 527(f) be eliminated and that all organizations, including § 501(c) organizations, be permitted to engage in political campaign intervention only through separate § 527 organizations to which contributions must be made directly.²⁹ With such changes, political campaign intervention would be prohibited for all § 501(c)

²⁶ This piece considers only statutory, not constitutional arguments. For a discussion of the constitutional issues, see generally Ellen P. Aprill, *Regulating the Political Speech of Nonprofit Noncharitable Exempt Organizations After Citizens United*, 10 ELECTION L.J. 363, 398 (2011) [hereinafter Aprill, *Regulating Political Speech*].

²⁷ Paul C. Barton, *Koskinen’s Comment on Political Spending of Nonprofit Disputed*, 147 TAX NOTES 31 (2015). Not all agree with the Commissioner’s assessment. *Id.*; see also *infra* note 111 (discussing exclusively).

²⁸ As explained further *infra* note 81, this conclusion is the same as Lloyd Hitoshi Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625 (2007), and his more recent piece, Lloyd Hitoshi Mayer, *Regulating Politics, Taxing Politics* (Dec. 5, 2014) [hereinafter Mayer, *Regulating Politics*] (unpublished manuscript) (on file with author), but it reaches this conclusion via a different route.

²⁹ As explained further in the text below, this position closely resembles the comments of Professors Don Tobin and Brian Galle and the Bright Lines Project on the 2013 Proposed Regulation as well as suggestions in recent scholarly work of others. See Bright Lines Project, *Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* (Feb. 28, 2014), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-135554>; Brian Galle & Donald Tobin, *Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* (Feb. 24, 2014), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-70943>; Mayer, *Regulating Politics*, *supra* note 28, at 42; Roger Colinvaux, *Political Activity and Tax Exemption: A Gordian’s Knot*, 34 VA. TAX REV. 1, 29–33 (2014). Also as explained in the text below, my preference is that all political campaign intervention take place through § 527 organizations that have raised funds for that purpose. I do, however, consider Professor Mayer’s suggestion that noncharitable exempt organizations be allowed an insubstantial amount of political campaign intervention.

organizations. Given the fate of the DISCLOSE Act,³⁰ which in general would require disclosure of donors who make contributions that could be used for political campaign intervention by nonprofit organizations, I do not have any expectation that such changes would be enacted any time soon. I argue, however, that such changes are needed to permit coherent regulation of political campaign intervention by § 501(c) organizations.

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

II. SUMMARY OF THE 2013 PROPOSED REGULATION

The 2013 Proposed Regulation would amend Treasury Regulation § 1.501(c)(4)-1(a)(2)(ii) to delete the current reference to “direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office,” language that closely resembles the definition of political campaign intervention in the § 501(c)(3) statute and regulations. The 2013 Proposed Regulation, drawing from § 527 and federal election law, instead posits that “[t]he promotion of social welfare does not include direct or indirect candidate-related political activity,” thus introducing the new term “candidate-related political activity.”³¹

The 2013 Proposed Regulation provides that candidate-related political activity includes activities that the IRS has traditionally considered to be political campaign activity *per se*, such as contributions to candidates and communications that expressly advocate for the election or defeat of a candidate. In defining candidate-related political activity for purposes of § 501(c)(4), however, the 2013 Proposed Regulation also draws key concepts from the federal election campaign laws, with some modifications. For example, the 2013 Proposed Regulation also would treat as candidate-

³⁰ The Democracy Is Strengthened by Casting Light on Spending in Elections (DISCLOSE) Act was first introduced in 2010 (H.R. 5175, 111th Cong. (2010) and S. 3628, 111th Cong. (2010)). Its most recent iteration, the DISCLOSE Act of 2015, was introduced by Senator Whitehouse in January 2015 and referred to committee. S. 229, 114th Cong. (2015). No further action has been taken.

³¹ Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,539 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

related political activity certain activities that, because they occur close in time to an election or are election-related, have a greater potential to affect the outcome of an election.³²

Consistent with the scope of § 527, the 2013 Proposed Regulation specifies that “candidate” means an individual who identifies himself or is proposed by another for selection, nomination, election, or appointment to any public office or office in a political organization, or to be a Presidential or Vice-Presidential elector, whether or not the individual is ultimately selected, nominated, elected, or appointed. In addition, the 2013 Proposed Regulation clarifies that for these purposes the term “candidate” also includes any officeholder who is the subject of a recall election. As the Treasury Department and the IRS acknowledge, defining “candidate-related political activity” in the 2013 Proposed Regulation to include activities related to candidates for a broader range of offices (such as activities relating to the appointment or confirmation of executive branch officials and judicial nominees) is a significant change.³³ Historically, political campaign intervention for § 501(c)(4) organizations has been defined, as it has for § 501(c)(3) organizations as applying only to elections for public office. The 2013 Proposed Regulation instead would apply a definition that reflects the broader scope of § 527.³⁴

Under the 2013 Proposed Regulation, candidate-related political activity includes communications that expressly advocate for or against a candidate. The 2013 Proposed Regulation draws from Federal Election Commission rules in defining “expressly advocate.” The Proposed Regulation enlarges this meaning of express advocacy to include communications expressing a view on the selection, nomination, or appointment of individuals, or on the election or defeat of one or more candidates or of candidates of a political party.³⁵ Under the 2013 Proposed Regulation, all communications—including written, printed, electronic

³² *Id.* at 71,538–39.

³³ *Id.* at 71,538.

³⁴ Some § 501(c)(4) organizations are already subject to this broader § 527 definition. If a § 527 organization engages in political campaign intervention as defined in § 527, it may be subject to tax under § 527(f). *See id.* at 71,536–41.

³⁵ *Id.* at 71,538.

(including Internet), video, and oral communications—that express a view, whether for or against, on a clearly identified candidate (or on candidates of a political party) would constitute candidate-related political activity. Clear identification in a communication includes name, photograph, or reference (such as “the incumbent” or a reference to a particular issue or characteristic distinguishing the candidate from others).³⁶ The 2013 Proposed Regulation also provides that candidate-related political activity includes “any express advocacy communication the expenditures for which an organization reports to the Federal Election Commission under the Federal Election Campaign Act as an independent expenditure.”³⁷

Under the proposed definition, candidate-related political activity would encompass any public communication that is made within sixty days before a general election or thirty days before a primary election and that clearly identifies a candidate for public office (or, in the case of a general election, refers to a political party represented in that election).³⁸ The 2013 Proposed Regulation borrows these time frames from those appearing in the Federal Election Campaign Act definition of electioneering communications.³⁹ The 2013 Proposed Regulation defines “election,” including what would be treated as a primary or a general election, to be consistent with § 527(j) and the federal election campaign laws.⁴⁰ A “public” communication is one made using certain mass media (specifically, by broadcast, in a newspaper, or on the Internet), constitutes paid advertising, or reaches or is intended to reach at least 500 people (including mass mailings or telephone banks).⁴¹ The 2013 Proposed Regulation also provides that candidate-related political activity includes any communication the expenditures for which an organization reports to

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.* at 71,539.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

the Federal Election Commission under the Federal Election Campaign Act, including electioneering communications.⁴²

The definition of candidate-related political activity in the 2013 Proposed Regulation would include

contributions of money or anything of value to or the solicitation of contributions on behalf of (1) any person if such contribution is recognized under applicable federal, state, or local campaign finance law as a reportable contribution; (2) any political party, political committee, or other § 527 organization; or (3) any organization described in § 501(c) that engages in candidate-related political activity,

a definition of contribution similar to the definition of contribution that applies for purposes of § 527.⁴³ The term “anything of value” would include both in-kind donations and other support (for example, volunteer hours and free or discounted rentals of facilities, or mailing lists).⁴⁴ The 2013 Proposed Regulation provides that, for purposes of this definition,

a recipient organization would not be treated as a § 501(c) organization engaged in candidate-related political activity if the contributor organization obtains a written representation from an authorized officer of the recipient organization stating that the recipient organization does not engage in any such activity and the contribution is subject to a written restriction that it not be used for candidate-related political activity.⁴⁵

This safe harbor requires that the contributor organization not know, or have reason to know, that the representation is inaccurate or unreliable.

An especially controversial provision of the 2013 Proposed Regulation defines candidate-related political activity to include certain specified election-related activities, including the conduct of voter registration and get-out-the-vote drives, distribution of material prepared by or on behalf of

⁴² *Id.* An electioneering communication under the federal election laws is one that refers to a clearly identified federal candidate, is distributed by a television station, radio station, cable television system or satellite system for a fee; and is distributed within 60 days prior to a general election or 30 days prior to a primary election to public office. See *Electioneering Communications, Campaign Finance Reports and Data*, FED. ELECTION COMM’N, <http://www.fec.gov/finance/disclosure/electioneering.shtml> (last visited Sept. 30, 2015).

⁴³ Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,539 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

⁴⁴ *Id.*

⁴⁵ *Id.*

a candidate or § 527 organization, and preparation or distribution of a voter guide and accompanying material that refers to a candidate or a political party.⁴⁶ The 2013 Proposed Regulation provides that activities conducted by an organization include, but are not limited to, (1) activities paid for by the organization or conducted by the organization's officers, directors, or employees acting in that capacity, or by volunteers acting under the organization's direction or supervision; (2) communications made (whether or not such communications were previously scheduled) as part of the program at an official function of the organization or in an official publication of the organization; and (3) other communications (such as television advertisements) the creation or distribution of which is paid for by the organization.⁴⁷ Under the 2013 Proposed Regulation, an organization's website is an official publication of the organization; thus, under the 2013 Proposed Regulation material posted by the organization on its Web site may constitute candidate-related political activity.⁴⁸

Quoting from the ABA Tax Section comments,⁴⁹ the 2013 Proposed Regulation sought public comment on twelve specific issues:⁵⁰

- The advisability of adopting a similar approach to the Proposed Regulation for § 501(c)(3) organizations, either in lieu of facts and circumstances, or in adding presumptions or safe harbors, and what modifications would be needed in the § 501(c)(3) context.
- The advisability of adopting a similar approach to the Proposed Regulation to define § 527 exempt function activity, in lieu of facts and circumstances.
- The advisability of adopting the Proposed Regulation's approach to defining activities that do not further the exempt purposes of § 501(c)(5) and (6) organizations.

⁴⁶ *Id.* at 71,539–40.

⁴⁷ *Id.* at 71,540.

⁴⁸ *Id.*

⁴⁹ Michael Hirschfeld, Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (May 7, 2014), <http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/050714comments.authcheckdam.pdf>.

⁵⁰ *Id.*

- What proportion of an organization's activities must promote social welfare to qualify for exemption under § 501(c)(4), and whether additional limits should be imposed on an organization's non-social-welfare activities.
- How to measure the activities of a § 501(c)(4) organization for purposes of applying the proportion-of-activities test.
- Whether the length of the pre-election period during which certain public communications defined in the Proposed Regulation are automatically treated as candidate-related political activity should be shorter or longer, and whether there should be exceptions for certain communications during the window.
- Whether the pre-election-window approach in the Proposed Regulation should apply to the period before an appointment, confirmation, or other selection event other than an election.
- Whether transfers other than those defined in the Proposed Regulation, such as indirect contributions to political parties or candidates under § 276, should be treated as candidate-related political activity.
- Whether any exceptions to the definition of candidate-related political activities are needed for voter education activities.
- Whether and under what circumstances material posted by a third party on an interactive part of an organization's web site should be attributed to the organization.
- Whether an organization's responsibility for linking to a third party's web site should be the same for purposes of candidate-related political activity as for § 501(c)(3) organizations under existing guidance.
- Whether other activities should be included in, or excepted from, the definition of candidate-related political activity.

As indicated by the Commissioner's remarks quoted above, it appears that coverage of any revised proposal will apply as well to other types of § 501(c) organizations, the amount of political campaign intervention to be allowed, and how to measure political campaign intervention. I note that many comments expressed particular dismay at the 2013 Proposed Regulation's treatment of nonpartisan efforts—including get out the vote, voter registration, candidate debates close to an election, and voter guides—as candidate-related political activity.⁵¹

⁵¹ See, e.g., Nan Aron, Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (Feb. 27, 2014),

III. SECTION 527

Prior to the 1974 congressional codification of the treatment of political organizations in § 527, the IRS struggled with how to treat political organizations.⁵² Congressional action in 1974 codified the taxation of political organizations by enacting § 527 and related provisions. Legislative history explained that “the questions involved in the area require a delicate balance between the need to protect the revenue and of the need to encourage political activities which are the heart of the democratic process.”⁵³ The Senate Finance Committee Report assumed that the IRS had historically not required the filing of income tax returns from political organizations on the basis that “the receipts of political organizations were from gifts,”⁵⁴ reasoning the IRS in fact had rejected.⁵⁵ The congressional committee concluded that “political activity (including the financing of political activity) as such is not a trade or business, which is appropriately subject to tax.”⁵⁶ Like the IRS, Congress decided that any income from investment, less direct expenses incurred in earning that income, should be subject to tax. Importantly, the Senate Finance Committee Report explicitly stated that present law permitted certain tax

<http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-124817>; Roslyn M. Brock & Lorraine C. Miller, Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (Feb. 28, 2014), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-126091>; Hirschfeld, *supra* note 49, at 12–13; National Advocacy Groups, Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (Feb. 27, 2014), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-123301>; Laura W. Murphy & Gabriel Rottman, Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (Feb. 4, 2014), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-21490>.

⁵² This section draws heavily from an earlier article by the author, *supra* note 26. That article gives further detail on the IRS struggles prior to 1974.

⁵³ S. REP. NO. 93-1357, at 26 (1974).

⁵⁴ *Id.* at 25.

⁵⁵ *Id.*

⁵⁶ *Id.* at 26.

exempt organizations, such as those exempt under § 501(c)(4), to engage in political activities.⁵⁷

As codified, § 527 defined a number of terms, clarified and, in some cases, expanded the IRS decisions. “Political organization” was defined as “a party, committee, association, fund or other organization (whether or not incorporated) organized and primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.”⁵⁸ An entity that met this definition was a political organization under § 527, subject to tax only to the extent provided in § 527, and considered an organization exempt from income taxes under § 527(a). There was no requirement that the organization apply for exemption; neither was the classification voluntary, except by meeting the description.⁵⁹

Under § 527 as originally enacted, the taxable income of a political organization was a political organization’s gross income, excluding exempt function income, over the deductions directly connected with production of the gross income.⁶⁰ Exempt function income is defined as

the function of influencing or attempting to influence the selection, nomination, election or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected or appointed.⁶¹

⁵⁷ *Id.* at 29.

⁵⁸ I.R.C. § 527(e)(1).

⁵⁹ I.R.S. Field Serv. Adv. Memo. 2000-37-040 confirms that § 527 status is not voluntary. As Professor Colinvaux points out, the FSA was published September 15, 2000, after the effective date of 2000 amendments to § 527, but its issue date of June 19 “indicates that its discussion is relevant with respect to the pre-2000 section 527 and nothing in the FSA can be read to the contrary.” Roger Colinvaux, *Regulation of Political Organizations and the Red Herring of Tax-Exempt Status*, 59 NAT. TAX J. 531, 541 n.23 (2006).

⁶⁰ I.R.C. § 527(c).

⁶¹ *Id.* § 527(e)(2). Regulations under § 527 elaborate. “Whether an expenditure is for an exempt function depends upon all the facts and circumstances,” but “[g]enerally where an organization supports an individual’s campaign for public office, the organization’s activities and expenditures in furtherance of the individual’s election or appointment to that office are for an exempt function of the organization.” Treas. Reg. § 1.527-2(c)(1) (as amended in 1985). Indirect expenses include those necessary to support the directly related expenses, such as expenses for overhead and recordkeeping necessary to allow the organization to be established, to engage in political activities and to solicit contributions. *Id.* Examples

Of particular import for my argument here, Congress also introduced the tax on political activities of § 501(c) entities, which is codified at § 527(f). This aspect of the legislation was intended to treat “these organizations on an equal basis for tax purposes with political organizations”⁶² by taxing them on their investment income to the extent of their political expenditures. The tax applies to the lower of these two amounts; a noncharitable tax-exempt entity that engaged in political expenditures but had no investment income would not owe any tax under § 527. Only after-tax funds are to be used for political campaign intervention. The Senate Committee Report observes in language that now seems to us idealistic or naive:

The committee expects that, generally, a § 501(c) organization that is permitted to engage in political activities would establish a separate organization that would operate primarily as a political organization, and directly receive and disburse all funds related to nomination, etc., activities. In this way, the campaign-type activities would be taken entirely out of the § 501(c) organization, to the benefit both of the organization and the administration of the tax laws.⁶³

of § 527 exempt function expenses in the regulations include the expenses of a candidate’s voice and speech lessons, the expenditures for tickets to a testimonial dinner, attendance at which is intended to aid a candidate’s reelection, and the expenses of financing seminars and conferences intended to influence persons who attend to support individuals to public office whose political philosophy is in harmony with that of the organization. Treas. Reg. § 1.527-2(c)(5)(ii), (iv), (viii) (as amended in 1985). One revenue ruling concludes that expenditures for an election night party were exempt function expenditures as an “inherent part of the . . . selection process,” even though they occurred after the outcome was determined. Rev. Rul. 87-119, 1987-2 C.B. 151. The regulations include two examples of exceptions from the definition of § 527 exempt function. The first is expenditures by a § 501(c) organization in connection with the testimony of its president in response to a written request from a Congressional committee in support of the confirmation of an individual to a cabinet position. Treas. Reg. § 1.527-2(d)(vi) (as amended in 1985). The other is nonpartisan voter registration and get-out-the vote campaigns, which require that the campaigns “not be specifically identified by the organization with any candidate or political party.” Treas. Reg. § 1.527-6(b)(5) (as amended in 1985).

⁶² I.R.C. § 527(e)(1); see Gregg D. Polsky, *A Tax Lawyer’s Perspective on Section 527 Organizations*, 28 CARDOZO L. REV. 1773 (2007); Gregg D. Polsky & Guy-Uriel E. Charles, *Regulating Section 527 Organizations*, 73 GEO. WASH. L. REV. 1000, 1014–16 (2005).

⁶³ S. REP. NO. 93-1357, at 30 (1974). As Professor Frances Hill has written, when § 527 was enacted,

[l]ittle thought was given to the relation between § 527 and the new FECA [(Federal Election Campaign Act)], although there appears to have been at least an implicit assumption that § 527 organizations would be subject to the FECA. One explanation for the minimal requirements for exemption under § 527 is that it was assumed that all § 527

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

That is, Congress wrongly anticipated that § 501(c) organizations would almost always establish a separate segregated fund, which need be no more than a bank account, which would be treated as a § 527 organization. The statutory structure, however, allowed for § 501(c) organizations to engage directly in exempt function activity, or political campaign intervention as defined in § 527, so long as they paid any applicable § 527(f) tax.⁶⁴

In enacting § 527, Congress largely followed the approach of the IRS regarding political organizations. It allowed the income devoted to political campaign intervention itself to be exempt from income taxation. It taxed other income, but also allowed deductions for producing that income. However, it defined the exempt function income more broadly than the IRS by including within its reach membership fees and proceeds from

organizations would be subject to the limitation under the FECA, which would have made further elaboration of limitations or positive requirements redundant.

Frances R. Hill, *Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle*, 26 EXEMPT ORG. TAX REV. 205, 207 (1999). Statements from Senator Lieberman confirm this insight. Shortly before amendments to § 527, Senator Lieberman wrote, “Section 527 has traditionally been understood to apply only to those organizations that registered as political committees under, and complied with FECA, unless they focused exclusively on state and local political activities.” Joseph Lieberman, *Campaign Finance*, 49 CATH. U. L. REV. 5, 8 (1999). During debates on the amendments he spoke more forcefully, asserting that “section 527 formerly had been generally understood to apply only to those organizations that register as political committees under, and comply with FECA, unless they focus on State or local activities or do not meet certain other specific FECA requirements.” 146 CONG. REC. S5995 (June 28, 2000).

⁶⁴ Congress resolved uncertainty about gift tax treatment of contributions to political organizations by enacting § 2501(a)(4), which excepts transfers to political organizations within the meaning of § 527(e)(1) from the gift tax. Congress believed that it was “inappropriate to apply the gift tax to political contributions because the tax system should not be used to reduce or restrict political contributions.” S. REP. NO. 93-1357, at 7508 (1974). At the same time, Congress provided that transfer of appreciated property to a political organization would be treated as a sale, and stated in the legislative history “if a decedent includes a political organization as a beneficiary of his estate, the amount so transferred is to be included in his estate.” *Id.* Thus, contributions to § 527 organizations had some protection from gift tax, but did not enjoy the same kind of shelter from transfer tax liability granted to charitable contributions.

fundraising events. It introduced taxation of § 501(c) organizations on their expenditures for political campaign intervention to the extent of their investment income.

Over the next two decades Congress made only small changes to § 527. In 1978, for example, proceeds from bingo games became a category of exempt function income,⁶⁵ and the rate of tax on taxable income of political organizations became the highest corporate rate.⁶⁶

Relying on revenue rulings that defined political campaign intervention for purposes of § 501(c)(3), the IRS in the mid- and late-1990's issued a number of private letter rulings regarding status as a political organization under § 527. These rulings reasoned that activities constituting § 501(c)(3) political campaign intervention would also constitute political campaign intervention (i.e. exempt function) for purposes of § 527.⁶⁷

In each of the § 527 private letter rulings, the IRS accommodated organizations that sought to be classified as § 527 political organizations and honored their intent, however subjective that might seem to be from the

⁶⁵ Proceeds from Bingo Games Act, Pub. L. No. 95-502, § 302(a), 92 Stat. 1693 (1978).

⁶⁶ Revenue Act of 1978, Pub. L. No. 95-600, § 301(b)(6), 92 Stat. 2763 (1978).

⁶⁷ To give one example of these rulings, I.R.S. Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999), acknowledged that some of the material that it intended to distribute and techniques that it may use “resemble the public education, issue advocacy or grass roots lobbying materials and techniques often used by charitable organizations without violating the political prohibition of § 501(c)(3) of the Code.” The organization also stated that it would be active in ballot measure, referenda, and initiatives, all activities traditionally carried on by § 501(c)(4) organizations. *Id.* The organization, however, represented that it would require each voter education project to be authorized by a board resolution describing the specific electoral goal and with its likelihood of impact substantiated by the opinion of experts, data collected from voter opinion polls, focus groups, and similar means or project planning sessions with campaign consultants, major donors and political functionaries. *Id.* Because the format, timing, and targeting of voter education and grassroots lobbying would be based on political considerations, the ruling concluded that these activities would be considered § 527 political campaign intervention. *Id.* In addition to this private letter ruling, the IRS also issued I.R.S. Priv. Ltr. Rul. 98-08-037 (Nov. 21, 1997), I.R.S. Priv. Ltr. Rul. 96-52-026 (Sept. 29, 1995), and I.R.S. Priv. Ltr. Rul. 97-25-036 (Mar. 24, 1997) during this period. For further discussion of these rulings and the issues they raise, see generally Rosemary E. Fei, *The Uses of Section 527 Political Organizations*, in 1 STRUCTURING THE INQUIRY INTO ADVOCACY, at 23, 26–28 (Elizabeth J. Reid ed., 2000), <http://www.taxpolicycenter.org/UploadedPDF/structuring.pdf>; Hill, *supra* note 63; Elizabeth Kingsley & John Pomeranz, *A Crash at the Crossroads: Tax and Campaign Finance Laws Collide in Regulation of Political Activities of Tax-Exempt Organizations*, 31 WM. MITCHELL L. REV. 55 (2004).

redacted rulings. The organizations sought assurance of § 527 classification for reasons related both to tax law and election law. The tax law motivation related to the gift tax. While contributions to § 501(c)(3) organizations are not subject to the gift tax,⁶⁸ such organizations will not be suitable vehicles for those seeking to influence legislation and elections. No code section, however, protects transfers to § 501(c)(4) (or other § 501(c) organizations) from gift tax, and at the time, gift taxation of transfers to § 501(c)(4) organizations was uncertain.⁶⁹ In contrast, contributions to § 527 political organizations are statutorily exempt from gift tax.⁷⁰ In the 1990's, a donor considering a large contribution to a politically-tinged lobbying effort would have preferred such endeavors to be structured as § 527 political campaign intervention. Traditional lobbying—acting to influence legislators or the public regarding legislation—is not, however, an exempt function under § 527. The shaping of such activities to qualify as exempt function activities is precisely what we see in these private letter rulings.

The election law motivation emerges from the limited jurisdiction of the FEC. At the time of these private letter rulings, an organization that engaged only in issue advocacy, that is, activity that stopped short of express advocacy,⁷¹ could do so without triggering any requirement that it report to the FEC, disclosing the sources and uses of funds, or limiting the amount of funding received from particular individuals or entities. Neither,

⁶⁸ I.R.C. § 2522(a)(2).

⁶⁹ After a controversy, the IRS announced in 2011 that it would not subject such transfers to gift taxation until further study. See Ellen Aprill, *Once and Future Gift Taxation of Transfers to Section 501(c)(4) Organizations: Current Law, Constitutional Issues, and Policy Considerations*, 15 N.Y.U. J. LEGIS. & PUB. POL'Y 289 (2012).

⁷⁰ I.R.C. § 2501(a)(4). That both § 501(c)(3) organizations and § 527 organizations are explicitly free from gift tax under explicit provisions of the Code, but § 501(c)(4) organizations are not strikes many as inconsistent. The House in April 2015 passed legislation, The Fair Treatment for All Gifts Act, H.R. 1104, 114th Cong. (2015), exempting contributions to § 501(c) organizations from gift tax. See Kenneth P. Vogel & Hillary Flynn, *House Quietly Passes Tax Exemption for Megadonors*, POLITICO (Apr. 16, 2015, 7:53 PM), <http://www.politico.com/story/2015/04/house-quietly-passes-tax-cut-for-megadonors-117067.html>. A number of exempt organizations and exempt organization lawyers expressed support for the legislation. *Organizations, Attorneys Support Exempt Org Deduction Bill*, TAX NOTES TODAY, Apr. 15, 2015, 2015 TNT 72-30 (LEXIS).

⁷¹ The provisions about electioneering communications, communications close in time to an election or primary that name a candidate, that were at issue in *Citizens United v. FEC*, 558 U.S. 310 (2010), were enacted later, as part of the Bipartisan Campaign Reform Act of 2002, H.R. 2356, 107th Cong. (2002) (enacted).

at the time, were such organizations subject to reporting or disclosure rules to the IRS under § 527 itself.⁷² Thus, while political organizations regulated by the FEC were one category of organizations subject to § 527, organizations that engaged only in issue advocacy, such as some of those that sought and received these private letter rulings,⁷³ created a new category of entities subject to § 527, one free to raise large amounts of money for political campaign intervention, subject only to the income tax rules of § 527, and without disclosure or reporting obligations. These entities came to be known as § 527 organizations, while the political entities regulated by the FEC are known as political action committees (PACs), although PACs are also in fact subject to tax under § 527.

The favorable response of the IRS in these private letter rulings further encouraged such tax-only regulated § 527 organizations, and they soon were dubbed “stealth 527 organizations.” The growth of the tax-regulated § 527 organizations prompted Congress to make substantial changes to § 527 in 2000. As Richard Briffault has described, “Public concern with the use of § 527 to fund issue advocacy while avoiding disclosure of the identity of the donors sponsoring the issue ads came to a head in early 2000” with millions of dollars spent on issue advocacy by § 527 organizations.⁷⁴ Within three months of their introduction, amendments to § 527 adding notification and disclosure requirements became law⁷⁵ with little formal legislative history.⁷⁶

Under these provisions, including amendments introduced in 2002,⁷⁷ an organization is not to be treated as an organization described in § 527

⁷² Vogel & Flynn, *supra* note 70.

⁷³ The organization in I.R.S. Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999) stated that it planned, as a minor part of its activities, to make expenditures reportable under the Federal Election Campaign Act and parallel state campaign finance laws. It also anticipated such activities as convening planning sessions with candidates and responding to requests from candidates in some cases.

⁷⁴ Briffault, *supra* note 12, at 959.

⁷⁵ Act to Amend the Internal Revenue Code of 1986 to Require 527 Organizations to Disclose Their Political Activities, Pub. L. No. 106-230, 114 Stat. 477 (2000).

⁷⁶ See Mayer, *supra* note 28.

⁷⁷ The 2002 amendments provided that § 527 organizations engaged solely in state and local electoral activity that report and disclose their contributions and expenditures under a qualifying state law regime need not file with the IRS, required that the registration notice be filed electronically,

unless it gives electronic notice that it is to be so treated within twenty-four hours after the date on which it is established or not later than thirty days after any material change. Failure to give the required notice renders exempt function income taxable.⁷⁸ This registration notice must include the names and addresses of the organization, its officers, directors, highly compensated employees, and related entities. Once registered, it must periodically file reports disclosing the names and addresses of contributors of \$200 or more per year and the amount, date and purpose of expenditures of \$500 or more per year.⁷⁹ Failure to make required disclosures in the time and manner described exposes the organization to a penalty equal to the highest corporate tax rate multiplied by the amount to which the failure relates.⁸⁰ Section 527 organizations are also required to file Form 990.⁸¹ The IRS and § 527 organizations must make these materials publicly available.⁸²

The disclosure requirements are strikingly similar to some of those imposed by FECA.⁸³ A House Committee Report on a similar but somewhat broader bill that did not become law acknowledged frankly, “Under the bill, the reporting periods and deadlines generally are the same as those required for reports under 2 U.S.C. 434(a) codifying the Federal Election Campaign Act of 1971 (FECA).”⁸⁴ Statements in the

required that reports of expenditures include the purpose of each expenditure, and required that the IRS make the registration notice and reports of expenditures and contributions available for public inspection on the Internet no later than 48 hours after such notice has been filed. Income Tax Notification and Return Requirements—Political Committees, Pub. L. No. 107-276, §§ 1–2, 5, 116 Stat. 1929 (2002).

⁷⁸ I.R.C. § 527(i)(4). Exempt function income is taxable until notice is given for a new organization or from the period of material change and until notice is given for a case of material change. *Id.*

⁷⁹ *Id.* § 527(j)(3).

⁸⁰ *Id.* § 527(j)(1).

⁸¹ *Id.* § 6033(g).

⁸² *Id.* § 6104(a)(1)(A). Form 1120-POL, the income tax return of political organizations, was originally also to be made public. *But see* § 3, 116 Stat. at 1931 (repealing that requirement).

⁸³ *See* Mayer, *supra* note 28, at 646 n.103 (comparing provisions).

⁸⁴ H.R. REP. NO. 106-702, at 17 (2000) (this bill would have imposed additional disclosure obligations on § 501(c) organizations engaged in political campaign intervention as well as on § 527 organizations. Contributors to § 501(c)(4), (5), and (6) organizations would have to be disclosed, unless

Congressional Record leading up to the legislation identify it with campaign finance reform. Senator Reed asserted that § 527 organizations “exemplify the failure of our existing campaign finance laws” and “skirt existing campaign finance laws,” but predicted that mandated disclosure “will close yet another legal loophole.”⁸⁵ Both Representative Castle and Senator Feingold described the legislation as “campaign finance reform.”⁸⁶ For Senator Lieberman, as for others, concerns about constitutionality also figured in shaping the legislation.⁸⁷ He asserted that *Buckley v. Valeo* permitted Congress to require disclosure by organizations whose major purpose is to elect candidates.⁸⁸ Important for our purposes, Senator Lieberman went on to say that the bill would be constitutional apart from *Buckley* on the basis of *Regan v. Taxation with Representation*,⁸⁹ because “any group not wanting to disclose information about itself or abide by the election laws would be able to continue doing whatever it is doing now—it would just have to do so without the public subsidy of tax exemption conferred by § 527.”⁹⁰ Nonetheless, he also described the debate and vote on the legislation as “the beginning of finally returning some limitation, some sanity, some disclosure, [and] some public confidence to our campaign finance laws.”⁹¹

the organization set up a segregated fund for earmarked contributions for political campaign intervention, in which case only contributors who earmark contributions would have been disclosed). *Id.*

⁸⁵ 146 CONG. REC. S10,182 (daily ed. June 9, 2000) (statement of Sen. Reed).

⁸⁶ 146 CONG. REC. E13,291 (daily ed. June 29, 2000) (statement of Rep. Castle); 146 CONG. REC. S12,848 (daily ed. June 28, 2000) (statement of Sen. Feingold).

⁸⁷ 146 CONG. REC. S12,849–50 (daily ed. June 28, 2000) (statement of Sen. Lieberman).

⁸⁸ *Id.*

⁸⁹ See *Regan v. Taxation with Representation*, 461 U.S. 540 (1983) (holding that the subsidy of tax exemption permitted limitation on communications protected by the First Amendment, in this case, lobbying limits applicable to § 501(c)(3) organizations).

⁹⁰ S. REP. NO. 106-702, at 12,850 (2000). The House Committee Report on the related bill identified the exemption from the gift tax as a particular tax benefit conferred upon § 527 organizations and stated of *Regan*, “[i]t is difficult to imagine that the Supreme Court would conclude that it is constitutional to eliminate a tax subsidy for certain activities, but not constitutional to require that organizations comply with reporting requirements with respect to those activities so that the IRS can monitor compliance with the law.” H.R. REP. NO. 106-702, at 15 (2000).

⁹¹ S. REP. NO. 106-702, at 12,850.

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

IV. THE PROBLEMATIC INTERACTION OF §§ 501(C) AND 527

Section 527 operates to place a number of limits on the Treasury and the IRS in revising the 2013 Proposed Regulation. Section 527 complicates attempts both to define political campaign intervention⁹² and to limit the amount of such activity to be permitted.

Sections 501(c) and 527, admittedly, define political campaign intervention for very different reasons—the former to narrow permitted activity and the latter to expand it. “Congress’s broad definition of § 527’s exempt function was intentional; its breadth was necessary in order to track and accommodate the wide range of income and activities that had previously been characterized as non-taxable by the IRS and that the IRS was then threatening to tax through administrative action.”⁹³ The 2013 Proposed Regulation borrows heavily from § 527’s definition of exempt function. By so doing, the 2013 Proposed Regulation accommodates those § 501(c)(4) organizations that are subject to the § 527(f) tax.

In § 527, however, Congress regulated § 501(c)(4) activity under § 527(f) only to the extent that a § 501(c)(4) organization acted like a § 527 organization. The § 527(f) tax works to prevent a possible abuse of using untaxed money for political campaign intervention; the definition of exempt function under § 527 was not designed or intended to serve as the general definition of political campaign intervention for § 501(c) tax-exempt organizations. As the ABA Tax Section comments observe, “the application of § 527(f) to § 501(c) organizations is a statutory stop-gap to prevent § 501(c) organizations from conducting § 527 exempt function activities while avoiding the tax on § 527 organizations.”⁹⁴ That is, the definition in

⁹² The 2013 Proposed Regulation’s borrowing from election law in defining candidate-related political activity is also a burden and a complication for exempt organizations. That complication, while requiring some discussion, is not the focus of this paper.

⁹³ Hirschfeld, *supra* note 49, at 19.

⁹⁴ *Id.* at 20.

§ 527 is intended to give as wide a scope as possible for political campaign activities free of tax for political organizations. The definitions for § 501(c) organizations have the opposite purpose—to specify those activities that, in general, do not carry out exempt purpose. The statutory language itself makes it difficult to keep these distinctions straight—“exempt function” for purposes of § 527 is not coterminous with activities eligible for exemption under § 501(c)(3). Many activities that constitute exempt function under § 527 are limited for noncharitable § 501(c) organizations and forbidden for § 501(c)(3) organizations.⁹⁵ Reconciling political campaign intervention under current law is fraught and difficult.

In response to the 2013 Proposed Regulation, comments from both left-leaning and right-leaning organizations argued that political campaign intervention under § 501(c)(4) should be defined narrowly as including only “express advocacy” as established under federal election law.⁹⁶ The 2013 Proposed Regulation defines “candidate-related political activity” to include “express advocacy.” They define express advocacy as “any communication . . . expressing a view on, whether for or against, the selection, nomination, election, or appointment of one or more clearly identified candidates or of candidates of a political party that” also “contains words that expressly advocate, such as ‘vote,’ ‘oppose,’ ‘support,’ ‘elect,’ ‘defeat,’ or ‘reject,’” or is susceptible to no reasonable interpretation other than a call for or against the selection, nomination, election, or appointment of one or more candidates or of candidates of a

⁹⁵ See I.R.S. Announcement 88-114, 1988-37 I.R.B. 26. To complicate matters even more, some activities that do constitute exempt function under § 527 are permitted even under § 501(c)(3), such as taking positions on judicial appointments. *Id.* The IRS proposed to characterize attempting to influence the confirmation of a federal judge, an activity in which a § 501(c)(3) organization can participate, as an exempt function activity for purposes of this provision and requested comments on this proposal. *Id.*; see also I.R.S. Gen. Couns. Mem. 39,694 (Jan. 22, 1988) (proposing that attempts to influence judicial and other executive branch appoints be taxable under § 527(f)). No final determination has been made.

⁹⁶ See Murphy & Rottman, *supra* note 51; Bradley A. Smith & Allen Dickerson, Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (Dec. 5, 2013), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0011>. Express advocacy, as established by the Supreme Court in *Buckley v. Valeo*, is “communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office.” 424 U.S. 1, 44 (1976). According to the FEC, express advocacy is a communication that when taken as a whole “could only be interpreted by a reasonable person as containing advocacy of the election or defeat of one or more clearly identified candidate.” 11 C.F.R. § 100.22(b) (2014).

political party.⁹⁷ As the earlier description of the 2013 Proposed Regulation makes clear, however, the 2013 Proposed Regulation does not limit the definition of candidate-related political activity to express advocacy.

In my view, § 527 constrains regulation under § 501(c)(4). It prevents limiting the definition of political campaign intervention for noncharitable tax-exempt organizations to express advocacy. Section 527, as amended, requires registration with and disclosure of contributions and expenditures by organizations other than those § 501(c) organizations that engage in exempt function activity directly, those that are required to report under the Federal Election Campaign Act,⁹⁸ and certain state organizations.⁹⁹ As noted earlier, § 501(c) organizations that engage directly in exempt function activity are potentially subject to tax under § 527(f). To be subject to such tax, the noncharitable exempt organization would have to engage in exempt function activity not covered by the exemption for organizations that report to the FEC under FECA. Since express advocacy must be reported to the FEC, noncharitable exempt organizations would have to engage in political campaign activity that did not qualify as express advocacy in order to be taxed under § 527(f). That is, the structure of § 527, in particular the inclusion of the tax under § 527(f), demonstrates Congress's intention that political campaign intervention within the meaning of § 527 "exempt function" reach more broadly than express advocacy and other activity subject to federal election law. Again, because of the operation of § 527, I believe that the definition of political campaign intervention for purposes of § 501(c)(4) must be broader than express advocacy. If political campaign intervention for noncharitable tax-exempt organizations, including § 501(c)(4) organizations, is defined only as engaging in express advocacy, § 527(f) would be essentially superfluous.¹⁰⁰ The limited legislative history

⁹⁷ Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

⁹⁸ I.R.C. § 527(i)(6).

⁹⁹ *Id.* § 527(i)(5)(B)–(C).

¹⁰⁰ Thus, the Taxpayer Advocate's suggestion that legislation "authorize the IRS to rely on a determination of political activity from the Federal Election Commission (FEC) or other programmatic agency," would limit political campaign intervention to a band far narrower than Congress intended when it enacted § 527, even if, as I have written, the amendments to § 527 are campaign finance laws in tax clothing. TAXPAYER ADVOCATE SERVICE, *supra* note 9, at 16; Aprill, *Regulating the Political*

we have of the 2000 amendments makes clear, § 527 envisions that § 501(c) organizations will engage in political campaign intervention beyond express advocacy.

Admittedly, § 527 reaches broadly to include appointed office, and the 2013 Proposed Regulation adopts this definition.¹⁰¹ The reliance in the 2013 Proposed Regulation on § 527 in defining “candidate,” and thus expanding the definition beyond elected to appointed offices as well as to those who have been proposed by others, marks an enormous change in the IRS interpretation. This change is one that I believe errs in failing to take into account both the language and the particular purposes of § 527, as opposed to the purposes of § 501(c). As noted earlier, Congress, in enacting § 527, chose to codify the existing IRS practice and to define political organization broadly in order to shield as many entities as possible from taxation. Under § 527(f)(2), for example, exempt function includes attempting to influence the selection of any “office in a political organization.” That is, § 527 uses the term “office,” not candidate.

For noncharitable § 501(c) organizations, the limits on political campaign intervention have applied only to elected public office. The IRS has not placed appointed office within the category of intervention in a political campaign, because it has based the definition of political campaign intervention applicable to all § 501(c) organizations on the language of § 501(c)(3),¹⁰² and § 501(c)(3) speaks of intervention in any political campaign of “any candidate for public office.” We do not usually consider those seeking or receiving appointed office as “candidates.” Treasury Regulation § 1.501(c)(3)-(1)(c)(iii) and Treasury Regulation § 53.4945-

Speech, supra note 26, at 391. So long as entities exempt from taxation can engage in political campaign intervention, the Treasury and the IRS will need to be involved in defining such activity.

¹⁰¹ Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,536 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

¹⁰² Revenue Ruling 67-368, 1967-2 C.B. 194, for example, held that comparative rating of candidates, even on a nonpartisan basis, is participation or intervention on behalf of candidates favorably rated and in opposition to those less favorably rated and thus cannot be the primary activity of a § 501(c)(4) organization. Revenue Ruling 81-95, 1981-1 C.B. 332, held that a § 501(c)(4) organization primarily engaged in activities that promote social welfare may also carry on lawful political campaign intervention. For examples of what constitutes political campaign intervention, Revenue Ruling 81-95 cited not only Revenue Ruling 67-368, but also a number of revenue rulings involving § 501(c)(3) organizations. *Id.*

(3)(a)(2) interpret a candidate for public office as “a contestant for an elective public office.” Congress enacted § 4955, the provision applying an excise tax on campaign intervention activities of § 501(c)(3), in 1987, more recently than § 527, and its definition of political campaign intervention carries particular weight.¹⁰³ Section 4955 defines political campaign intervention, which it dubs “political expenditure,” in the same way as § 501(c)(3).¹⁰⁴ Similarly, § 501(c)(29), enacted in 2010 as part of the Affordable Care Act, defines a tax-exempt health insurance carrier using the same language as § 501(c)(3) regarding political campaign intervention.¹⁰⁵

As a number of comments on the 2013 Proposed Regulation observed, as a practical matter, the impact of any definition of political campaign intervention for an exempt organization depends on the amount of such activity permitted. That is, those affected cannot evaluate fully any proposed regulation unless the proposal specifies the amount of political campaign intervention that would be permitted.¹⁰⁶ An expansive definition of political campaign intervention has far less of an impact on § 501(c) organizations if a large amount of such activity is permitted; if no or little of such activity is permitted, then a broad definition sharply constrains the activity of these entities.

Some comments on the 2013 Proposed Regulation, including most eloquently those by Representative Van Hollen, Democracy 21, and the Campaign Legal Center, have argued that the applicable statutory language requiring that § 501(c)(4) entities be “operated exclusively for the promotion of social welfare” means that they can engage in no political

¹⁰³ Hirschfeld, *supra* note 49, at 21–22.

¹⁰⁴ “The term ‘political expenditure’ means any amount paid or incurred by a § 501(c)(3) organization in any participation in, or intervention in (including in opposition to) any candidate for public office.” I.R.C. § 4955(d)(1). The definition also explicitly includes some additional expenses such as conducting polls, surveys, and expenses of advertising, publicity and fundraising. *Id.* § 4955(d)(2).

¹⁰⁵ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 1322, 124 Stat. 119, 191 (2010).

¹⁰⁶ Hirschfeld, *supra* note 49, at 3–4; *see* Rep. Chris Van Hollen et al., Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (Feb. 27, 2014), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-126088>.

campaign intervention whatsoever,¹⁰⁷ despite the absence of an explicit prohibition, such as that found in § 501(c)(3). This conclusion relies on two propositions, first, that political campaign intervention does not promote social welfare (a position that is consistent with the current regulation), and second, the position that the current regulation exceeds statutory authority when it reinterprets “exclusively” as “primarily.”¹⁰⁸

As to the first position, other comments on the 2013 Proposed Regulation question the assumption that political campaign activity fails to promote social welfare. Although the 2013 Proposed Regulation would consider nonpartisan activities as candidate-related political activity, according to the Alliance for Justice, for example, “it cannot be denied that promoting civic participation and engagement by citizens, improving democracy by educating voters, and educating candidates about the needs of the community all promote the common good and general welfare of the community.”¹⁰⁹

For me, the best argument that promotion of social welfare should not include political campaign activity for the purposes of tax law has been made in connection with the prohibition of such activities by charities, both in this country and elsewhere. For example, a 2008 Pamphlet from the Charities Commission of England and Wales explains,¹¹⁰

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

¹⁰⁷ Van Hollen et al., *supra* note 106, at 7–8. The discussion that follows is intended to address as well a variation of this position (that such organizations be allowed to engage in a *de minimis* amount of political campaign literature).

¹⁰⁸ Professor Miriam Galston argued for relying on the statutory language in a June 4, 2015 *Washington Post* op-ed piece. Miriam Galston, *The IRS’s Chief’s Mistake About Dark Money*, WASH. POST, June 14, 2015, http://www.washingtonpost.com/opinions/the-irs-chiefs-mistake-about-dark-money/2015/06/04/0f4a22ae-095e-11e5-9e39-0db921c47b93_story.html.

¹⁰⁹ Aron, *supra* note 51, at 2.

¹¹⁰ Charity Comm’n, *Speaking Out: Guidance on Campaigning and Political Activity by Charities* (CC9), at 15 (2008) (U.K.), <http://www.charitycommission.gov.uk/media/94387/cc9text.pdf>.

Similarly, a § 501(c)(4) organization must act in accordance with its exempt purpose. Thus, such organizations may lobby without limit, so long as the lobbying is related to their exempt purpose.¹¹¹ Engaging in political campaign intervention will inevitably involve issues not related to such organizations' exempt purposes. Terence Dougherty and Professor Lloyd Hitoshi Mayer make another compelling point to reach a similar conclusion. They argue that political campaign intervention does not constitute social welfare because such activities involve impermissible private benefit.¹¹²

As for the argument about “exclusively” in the statutory language, as I have argued elsewhere,¹¹³ the IRS and Treasury did not contradict, but carried out congressional intent in reinterpreting “exclusively” as “primarily.” This regulatory reinterpretation was needed after 1950, when Congress enacted a set of rules known as the unrelated business income tax, or the UBIT. Pre-UBIT, tax exemption depended on the destination, not the source of the income. Famously, the New York University owned Mueller Macaroni, which operated free of tax because its profits supported the school's exempt activities. Spurred by such concerns over unfair competition and lost revenue, Congress enacted the UBIT. The UBIT taxed any trade or business regularly carried on by § 501(c) organizations if the

¹¹¹ Rev. Rul. 61-177, 1961-1 C.B. 117. “Organizations described in IRC 501(c)(4), (c)(5), and (c)(6) may engage in an unlimited amount of lobbying, provided that the lobbying is related to the organization's exempt purpose.” John Francis Reilly & Barbara A. Braig Allen, *Political Campaign and Lobbying Activities of IRC 501(c)(4), (c)(5) and (c)(6) Organizations*, IRS (Oct. 2002), <http://www.irs.gov/pub/irs-tege/eotopic103.pdf>.

¹¹² See Terence Dougherty, *Section 501(c)(4) Advocacy Organizations: Political Candidate-Related and Other Partisan Activities in Furtherance of the Social Welfare*, 36 SEATTLE U. L. REV. 1337, 1393–1400 (2013); Lloyd Hitoshi Mayer, *Disclosure about Disclosure*, 44 IND. L. REV. 255 (2010); Mayer, *Regulating Politics*, *supra* note 28.

¹¹³ Ellen P. Aprill, *The IRS's Tea Party Tax Row: How “Exclusively” Became “Primarily.”* PAC. STANDARD (June 7, 2013), <http://www.psmag.com/politics/the-irss-tea-party-tax-row-how-exclusively-became-primarily-59451>. The following paragraphs are based on this op-ed. See Colinvaux, *supra* note 29, at 30 n.130 (noting one former Treasury official, reflecting on these regulations, has written that “Treasury determined that it could not legally support the position that an organization could lose its exempt status as a result of substantial unrelated business activity” (quoting Thomas A. Troyer, *Quantity of Unrelated Business Consistent with Charitable Exemption—Some Clarification*, 56 TAX NOTES 1075 (1992))); see also STAFF OF J. COMM. ON TAXATION, 109TH CONG., HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS, at 49 n.70 (Joint Comm. Print 2005).

activity is not related—aside from the need for funding—to the organization’s exempt purpose.

The UBIT rules acknowledged and accepted that exempt organizations could engage in activities that did not carry out their exempt purpose. Thus, the earlier statutory language requiring that § 501(c)(3) and § 501(c)(4) organizations operate “exclusively” for their exempt purposes no longer accurately described the applicable law. Treasury regulations then reinterpreted “exclusively” as “primarily” for both § 501(c)(3) and § 501(c)(4).¹¹⁴

In the case of § 501(c)(4) organizations, the applicable regulation specified that the “promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.”¹¹⁵ This IRS regulation, although not issued until 1959, specified that it applied retroactively to 1953.¹¹⁶ The proposed § 501(c)(4) regulation issued in 1956 made no reference to political campaign intervention;¹¹⁷ discussion of political campaign intervention by § 501(c)(4) organizations came only after further consideration. The set of 1956 proposed regulations, however, did include an elaborate set of proposed UBIT regulations.¹¹⁸ Like the regulations as adopted, the 1956 proposed § 501(c)(4) regulations used “primarily” rather than “exclusively,”¹¹⁹ and offer further evidence of the connection between UBIT and the administrative interpretation of “exclusively” as “primarily.”

¹¹⁴ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (1960).

¹¹⁵ Notice of Proposed Rulemaking, 24 Fed. Reg. 1421, 1423 (proposed Feb. 26, 1959) (to be codified at 26 C.F.R. pts. 1, 301).

¹¹⁶ T.D. 6391, 1959-2 C.B. 139.

¹¹⁷ See Notice of Proposed Rulemaking Relating to Exempt Organizations, 21 Fed. Reg. 460, 465 (proposed Jan. 21, 1956) (to be codified at 26 C.F.R. pt. 1). These proposed regulations were withdrawn when revised regulations were proposed in 1959. See *supra* note 115.

¹¹⁸ Notice of Proposed Rulemaking Relating to Exempt Organizations, 21 Fed. Reg. 460, 470–78 (proposed Jan. 21, 1956) (to be codified at 26 C.F.R. pt. 1).

¹¹⁹ *Id.* at 465.

Critics of the “primarily” language in the regulations often point to language in a 1945 Supreme Court opinion, *Better Business Bureau*,¹²⁰ that the presence of any substantial non-exempt purpose will destroy exemption. “Purpose,” however, is not the same as “activity,” and the 1959 § 501(c)(3) and § 501(c)(4) regulation focuses on the nature of the exempt organization’s operations and activities, not their purpose. Moreover, *Better Business Bureau* predated the UBIT regime and thus could not consider the impact of unrelated activities on exemption.¹²¹

But more important for purposes of this paper, regulations for § 501(c) social welfare and other noncharitable exempt organizations that prohibit them from engaging in any political campaign intervention would be inconsistent with § 527, a provision enacted long after § 501(c)(4) and the UBIT provisions. Section 527(f)(3) specifically authorizes a § 501(c) organization to set up a separate segregated fund treated as a political organization under § 527 to engage in exempt functions free of tax.¹²² That is, the statute anticipates use of § 501(c) monies for such activity.

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

¹²⁰ *Better Bus. Bureau v. United States*, 326 U.S. 279 (1945). Appellate courts, however, applied *Better Business Bureau* to § 501(c)(4) organizations. See, e.g., *Vision Serv. Plan v. United States*, 265 F. App’x 650, 651 (9th Cir. 2008); *Am. Ass’n of Christian Schools Voluntary Emps. Beneficiary Ass’n Welfare Plan Trust v. United States*, 850 F.2d 1510, 1515–16 (11th Cir. 1988); *Police Benevolent Ass’n v. United States*, 661 F. Supp. 765, 773 (E.D. Va. 1987), *aff’d without opinion*, 836 F.2d 547 (4th Cir. 1987); *Mutual Aid Ass’n of the Church of the Brethren v. United States*, 759 F.2d 792, 796 (10th Cir. 1985); *Contracting Plumbers Coop. Restoration Corp. v. United States*, 488 F.2d 684, 686 (2d Cir. 1973).

¹²¹ In retrospect, we might wish that the 1959 regulations had permitted only unrelated activity subject to the unrelated business income tax, on the basis that, while the activity itself may be related to exempt purpose, unrelated business activities are intended to raise funds for exempt purposes. They did not, however, do so. Moreover, they were not silent about § 501(c)(4) political campaign intervention. They considered this issue and addressed it.

¹²² *Treas. Reg. § 1.527-6(e)* (1980).

The Campaign Legal Center argues that taxing this activity does not mean that it is a permitted activity. “That such activity is taxable does not mean that it is permissible at all.”¹²³ Such reasoning seems to me inconsistent with the purpose and legislative history of § 527. The § 527(f) tax is intended to ensure that all money spent on political campaign intervention is taxed at least once, simply as a means to ensure a level playing field.¹²⁴ It is not a sanction.

In that regard, § 527(f) stands in sharp contrast to the tax under § 4955, which is an excise tax imposed on § 501(c)(3) organizations as a sanction for violating the prohibition on political campaign intervention. As the IRS has explained, “Congress viewed the IRC 4955 taxes . . . primarily as an additional tax and, secondarily as a sanction to apply instead of revocation in certain limited situations. . . . The 1987 enactments were intended to strengthen . . . the prohibition on political campaign activity.”¹²⁵ Section 4955 regulations specify that the excise taxes imposed by the provision do not affect the standards for exemptions under § 501(c)(3).¹²⁶ Section 4955 and its legislative history do not support a reading of § 527(f) that narrowly limits the amount of political campaign intervention permitted to § 501(c)(4) organizations.

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

¹²³ Van Hollen et al., *supra* note 106.

¹²⁴ H.R. REP. NO. 106-230, at 12 (2000) (Conf. Rep.).

¹²⁵ Judith E. Kindell & John Francis Riley, *Election Year Issues*, IRS 335, 353–54 (2002), <http://www.irs.gov/pub/irs-tege/eotopici02.pdf>.

¹²⁶ Treas. Reg. § 53.4955-1(a) (1995).

treatment. They would probably be categorized as taxable entities,¹²⁷ but without certainty as to how contributions and expenditures would be characterized and without public filing of annual information returns. As Professors Galle and Tobin observed in their comments on the 2013 Proposed Regulation, “Without further clarification by the IRS, taxable organizations may be the next vehicle of choice to avoid campaign finance disclosure, and may once again embroil the IRS in unnecessary political decisions.”¹²⁸

Thus, any significant reduction in the amount of political campaign intervention is problematic not only because of the current structure of the Code, but also as a practical matter. In part out of concern for this gap,¹²⁹ the comments of the ABA Tax Section comments on the 2013 Proposed Regulation assume a 40% limit.¹³⁰ The Comments explain that a 40% limit by monetary expenditure “include relative ease of computation and administration, while at the same time ensuring social welfare purposes and activities remain materially above one-half of total activities.”¹³¹ The ABA Tax Section Comments reject a 49% limit on the grounds that a 49% limit “requires a level of precision that is difficult to administer, allows no room for error by the organization or the IRS, and may encourage abusive uses of § 501(c)(4) exempt status.”¹³² The ABA also recommended that “the minimum level of political intervention required for § 527 exemption be

¹²⁷ See Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 GA. L. REV. 611, 673 (2003); see also Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They the Next “Loophole”?*, 6 FIRST AMEND. L. REV. 41, 49–50 (1997).

¹²⁸ Galle & Tobin, *supra* note 29, at 18. Mayer does not find such a gap disturbing, because he views political contributions not as income and political activity expenses not deductible under general tax principles. See generally Mayer, *Regulating Politics*, *supra* note 28.

¹²⁹ The ABA Tax Section comments describe as a concern the absence of any tax-exempt status for an organization all of whose activities would be exempt under either § 501(c)(4) or § 527, except that it engages in more than the permitted amount of political intervention under § 501(c)(4), but less than substantially all political intervention as required by § 527. This gap will be larger, the lower than limit set on political intervention by 501(c) organizations. Hirschfeld, *supra* note 49, at 7–8.

¹³⁰ *Id.* at 6. As the ABA comments explain, the IRS used a 40% limit for expedited review of backlogged Form 1024 applications for exemption under § 501(c)(4), and a 2004 ABA Tax Force suggested a 40% limit, although the two principal authors of the 2004 Report have more recently endorsed limits lower than 40%. *Id.* at n.35.

¹³¹ *Id.* at 6.

¹³² *Id.* at 7.

adjusted to approach or mirror the maximum under § 501(c)(4): we see no public policy justification for withholding tax-exempt status from nonprofit organizations that fall in the gap.”¹³³

While I personally would prefer a limit for political campaign intervention by noncharitable § 501(c) organizations well below 40%, I find a low limit difficult to justify under current law. Treasury and the IRS could, by regulation, deem 40% by money expenditure to be a safe harbor, as happened with expedited review of applications for exemption under § 501(c)(4),¹³⁴ but I see a significant risk, even with the deference given to Treasury regulations,¹³⁵ that a 40% maximum by money expenditure would be sustained upon challenge.¹³⁶

Section 527, therefore, poses a number of dilemmas for those drafting regulations regarding political campaign intervention by § 501(c) organizations. My own concern for abusive uses of § 501(c) exempt status and belief in the benefits of disclosure of contributors beyond those required currently under FECA lead me to call for fundamental changes to § 527 and to § 501(c),¹³⁷ as explained below.

¹³³ *Id.* at 8.

¹³⁴ *See id.* at 6.

¹³⁵ *See Mayo Found. for Med. Educ. & Res. v. United States*, 562 U.S. 44, 55–56 (2011). Although *Mayo* makes clear that Treasury regulations can adopt new positions, the IRS and Treasury, in deciding on the permitted amount of political campaign intervention, may well take into account the many decades of many existing organizations’ understanding of and reliance on a “less than 50%” interpretation of “primarily.” *See supra* note 7.

¹³⁶ Professors Galle and Tobin recommend capping § 501(c)(4) political campaign expenses at some amount lower than \$1 million. Galle & Tobin, *supra* note 29, at 9–10. They would have the IRS and Treasury interpret the “primarily” language defining a political organization under § 527(e)(1) to mean “substantially” and define “substantially” to be ten percent of a § 527 organization’s budget or no more than an overall cap, such as \$1 million. *Id.* at 3, 9. Arguably, new regulations under § 527 reinterpreting “primarily” as “substantially” parallel the current § 501(c)(4) regulations interpreting “exclusively.” However, I do not see the same justification for such a change as introduction of the UBIT offered for the § 501(c)(4) regulation and thus believe legislative change is needed to achieve such a result, however sympathetic I am to the structure Galle and Tobin endorse.

¹³⁷ Justifications for disclosure are discussed below in connection with *Citizens United v. FEC*, 558 U.S. 310 (2010). For purposes of this piece, I accept the Court’s arguments in that case and do not make an independent argument regarding the costs and benefits of disclosure. *See generally* Mayer, *Disclosure About Disclosure*, *supra* note 112; Mayer, *Regulating Politics*, *supra* note 28, at 43–44.

V. RECOMMENDATIONS FOR CHANGE

The world today regarding political campaign intervention differs substantially not only from the 1970's, when § 527 was enacted, but even from 2000, when it was amended. The prominence of § 501(c) organizations in political campaign intervention also reflects this changed world. In 2006, § 501(c)(4) organizations spent \$1.3 million on political spending, and by the 2012 election, that number ballooned to \$256 million.¹³⁸ According to the Center for Responsive Politics as of May 6, 2015, spending by tax-exempt organizations not required to disclose donors totaled more than \$300 million in the 2012 election and more than \$174 million in the 2014 midterm elections.¹³⁹

As discussed above, the legislative history of the amendments to § 527 indicates that Congress saw it as campaign finance reform, but believed it needed tax exemption and thus a place in the Code as a constitutional hook for requiring disclosure. *Citizens United* strongly suggests that such is no longer the case.¹⁴⁰ Campaign finance reform represented by the amendments to § 527, in particular the disclosure of contributions and expenditures for political campaign intervention, no longer should, but also clearly can, be moved out of the IRC and to the FECA.

In *Citizens United*, all of the Justices except Justice Thomas upheld the disclaimer and disclosure requirements required of Citizens United under election law.¹⁴¹ Such requirements, Justice Kennedy wrote, while they burden the ability to speak, “impose no ceiling on campaign-related activities.”¹⁴² Thus, they “are subject to exacting scrutiny,” which requires a “substantial relation between them and a sufficiently important government

¹³⁸ Sheila Krumholz, Comment Letter on Proposed Regulations Regarding Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (Feb. 26, 2014), <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-115413>.

¹³⁹ Ctr. for Responsive Politics, *Outside Spending: Political Nonprofits (Dark Money)*, OPENSECRETS.ORG, https://www.opensecrets.org/outsidespending/nonprof_summ.php (last updated Oct. 11, 2015).

¹⁴⁰ See *Citizens United v. FEC*, 558 U.S. 310 (2010).

¹⁴¹ *Id.* at 366–67.

¹⁴² *Id.* at 366 (quoting *Buckley v. Valeo*, 424 U.S. 1, 64 (1976)).

interest.”¹⁴³ Justice Kennedy found that the same interest that sustained facial challenges to such provisions, namely helping citizens to “make informed choices in the political marketplace,” applied here.¹⁴⁴ Moreover, because “disclosure is a less restrictive alternative to more comprehensive regulations of speech,” disclosure requirements need not be limited to speech that is the functional equivalent of express advocacy.¹⁴⁵

Citizens United argued that disclosure requirements can chill donations to an organization by exposing donors to retaliation, but the Court concluded that the organization had not made a showing of harassment or retaliation in its case. In fact, the “First Amendment protects political speech; and disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and to give proper weight to different speakers and messages.”¹⁴⁶

Under this reasoning, the disclosure currently required could be moved from the IRS to the FEC.¹⁴⁷ I believe Congress could and should do so. As Lloyd Mayer has recently discussed consideration of relevant effectiveness, on the one hand, and the risk of collateral reputational harm to an agency as a result of regulating disclosure in connection with political campaign intervention, on the other, favors assigning responsibility for disclosure to the FEC.¹⁴⁸ Despite the deadlocking that the FEC has experienced in regulating, including in connection with regulation of disclosure, given its

¹⁴³ *Id.* at 366–67 (quoting *Buckley*, 424 U.S. at 64).

¹⁴⁴ *Id.* at 367.

¹⁴⁵ *Id.* at 369.

¹⁴⁶ *Id.* at 371.

¹⁴⁷ As noted earlier, Lloyd Mayer has made an argument for such a move based on greater institutional competence by the FEC. See Mayer, *The Much Maligned 527 and Institutional Choice*, *supra* note 28, at 627–28. At the time he wrote his article, *Citizens United* had not been decided. He more recently reached the same conclusion under a slightly different framework. See generally Mayer, *Regulating Politics*, *supra* note 28. As he credits, Professor Lily Kahng emphasized the risk to the IRS as a whole and its role as revenue collector as a result of the reputational harm suffered because of its treatment of § 501(c)(4) organizations. Lily Kahng, *The IRS Tea Party Controversy and Administrative Discretion*, 42 CORNELL L. REV. ONLINE 41, 51–52 (2013).

¹⁴⁸ Mayer, *Regulating Politics*, *supra* note 28, at 18. If new laws giving the FEC such power are not feasible, however, Mayer would look to the IRS because “a poor tool is better than no tool at all.” *Id.*

current structure of three commissioners appointed from each of the two major political parties,¹⁴⁹ its expertise includes, at its core, disclosure about political campaign intervention as such intervention occurs. Any failures or successes in this regard involve its core activities. The FEC also has more resources than the IRS to enforce disclosure requirements.¹⁵⁰ Professor Colinvaux also endorses moving responsibility for disclosure from the IRS to the FEC.¹⁵¹

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

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

That is, I would require all political campaign intervention to be conducted through § 527 organizations, which, recall, need be no more than a bank account.¹⁵² Under this regime, neither for-profit nor exempt organizations could engage directly in political campaign intervention, under the broad definition of exempt function provided in § 527. Section 527(f) would be repealed, although the tax on investment income would be retained. With such changes to § 527, it would be possible to require, either

¹⁴⁹ *Id.* at 15.

¹⁵⁰ *Id.* at 16–17.

¹⁵¹ Colinvaux, *supra* note 29, at 48.

¹⁵² I note that Professor Colinvaux suggests as one possibility, the opposite approach—that limits on the political activity of noncharitable exempt organizations be eliminated. *Id.* at 49–50.

through legislation or regulation, which exempt organizations engage in no political campaign intervention or only an insubstantial amount of such activity. I do not think that such limits are possible under current law.¹⁵³ With these changes, it might also be appropriate to introduce some kind of excise tax as a sanction short of revocation in appropriate circumstances for violation of the prohibition.¹⁵⁴

At the same time that I recommend limiting the permissible activities for noncharitable § 501(c) organizations. I would, as have a number of others, urge that the permissible activities of § 527 organizations be broadened. Thus, like Professors Galle and Tobin, I would redefine § 527 so that it encompasses any organization that engages substantially in political campaign intervention, although, as noted earlier, I believe legislation is needed for such a change.¹⁵⁵ Professor Colinvaux also suggests expanding tax exemption for political organizations “to include income from noncharitable exempt purposes (in particular for social welfare, labor, and trade association purposes).”¹⁵⁶ The comments of the Bright Lines Project also suggest that § 527 “be amended to fit within the system by providing a tax-exempt home for ANY organization that fails to qualify under a § 501(c) category due to excessive political activity, even if that activity is less than primary.”¹⁵⁷ In my view, any contribution to or

¹⁵³ If noncharitable § 501(c) organizations could engage in an insubstantial amount of political campaign intervention, they could transfer funds from their treasuries to related § 527 organizations.

¹⁵⁴ This suggestion very closely resembles that of Professor Mayer, although he prefers an insubstantial part rule because “the penalty of loss of tax exemption status is relatively draconian and so should not be triggered by an insubstantial level of activity.” Mayer, *Regulating Politics*, *supra* note 28, at 40. An excise tax on insubstantial political campaign intervention, however, would avoid loss of exemption without the need for having an insubstantial part rules.

¹⁵⁵ *See supra* note 136.

¹⁵⁶ Colinvaux, *supra* note 29, at 50. He continues, “This would have the effect of eliminating the sanction for breach of the political activity limits by a noncharitable exempt. . . . The 527(f) tax would be replaced in effect with a tax on investment income.” *Id.*

¹⁵⁷ Bright Lines Project, *supra* note 29, at 18. The Bright Lines Project suggests that the § 527 regulations also be re-drafted “to adopt the same standards as applies to 501(c)s.” *Id.* at 19. It makes a number of other specific suggestions, more detailed than the discussion in this article, regarding § 527 and regulations under § 527, both in its comments and on its webpage. *See* PUB. CITIZEN, THE BRIGHT LINES PROJECT: CLARIFYING IRS RULES ON POLITICAL INTERVENTION 9–10 (2014), <http://www.brightlinesproject.org/wp-content/uploads/2015/06/May-8-Explanation-with-Exhibit.pdf>. For example, the Bright Lines Project recommends “continuing the exemption of internal member communications and

expenditure by a § 527 organization, whether or not for political campaign intervention, should, however, require disclosure.

The amendments suggested above would achieve disclosure and channel political campaign intervention more simply than the DISCLOSE Act of 2015.¹⁵⁸ Any substantial campaign intervention would take place only through a § 527 organization. Thus, there would no longer be any need for the provisions under DISCLOSE that § 501(c) organizations either report contributions that could be used for campaign intervention or undertake the heavy burden of prohibiting, in writing, use of disbursements for political campaign intervention.¹⁵⁹

In short, the failure of congruence between § 527 and other provisions of the Code as well as the impact of *Citizens United*, both as a practical matter and in connection with the justifications for enacting the 2000 amendments to § 527, call for Congress to amend § 527 with amendments that will make it possible for the Treasury and the IRS to promulgate meaningful regulations regarding political campaign intervention by noncharitable exempt organizations.

VI. CONCLUSION

As the race for the 2016 Presidential campaign continues, the need for guidance on what political campaign intervention is permitted under the Code for noncharitable tax-exempt organizations becomes more apparent. The importance to the electorate about who is funding political campaign intervention grows as well. The first attempt by the Treasury and the IRS to offer at least some guidance, the 2013 Proposed Regulation, failed. While a new version would likely improve on the 2013 Proposed Regulation, without changes to the applicable statutory provisions, tax administrators will face severe limits on the guidance they can offer. Perhaps, however, a brief opportunity for needed legislation will exist shortly after the 2016 election, if the new President, the Congress, the press, and the public reflect

indirect fundraising and administrative costs, currently tax-free for 501(c) groups under the 527 regulations.” *Id.* at 10.

¹⁵⁸ See DISCLOSE Act of 2015, S. 229, 114th Cong. § 2(b) (2015).

¹⁵⁹ *Id.*

on the financial costs and the cost to our democracy of the current interaction between our tax and campaign finance laws.