NATIONAL CENTER ON PHILANTHROPY AND THE LAW

POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS: FEDERAL INCOME TAX RULES AND RESTRICTIONS

OCTOBER 29, 1998

by

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POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS: FEDERAL INCOME TAX RULES AND RESTRICTIONS

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"Political agitation . . . however innocent the aim . . .
must be conducted without public subvention . . . ."[1]

Judge Learned Hand wrote these words in 1930, some two and one-half decades before Section 501(c)(3)[2] was amended to include an express prohibition against intervention in political campaigns. Although the case involved legislative activities of the American Birth Control League, Judge Hand's admonition has been accepted by Congress and the courts alike as an equally valid rationale for the prohibition on political campaign activities by Section 501(c)(3) organizations.[3] But exactly what kind of "political agitation" is proscribed? Where is the line between education (or religion) and politics, and is it clear enough to give fair warning to charities that want to walk close to the edge but not over it? Are there legislative or regulatory changes that might make the line clearer and better align the interests of charities and politicians in staying inside it? And finally, how

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1 Slee v. Commissioner, 42 F.2d 184 at 185 (2d Cir. 1930).

2 Unless otherwise indicated, all Section references are to the Internal Revenue Code of 1986, as amended.

3 See, e.g., Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876, 879 (2d Cir. 1988). See also H.R. Rep. No. 100-391, at 1624-25 (1987) ("The prohibition on political campaign activities and the restriction on lobbying activities by charities reflect Congressional policies that the U.S. Treasury should be neutral in political affairs . . .").

might Congress best approach this subject, where the conflict of interest -- spanning party lines -- is so clear?

This paper will wrestle with these issues. Beginning with an overview of the current federal income tax rules on political campaign activities by tax-exempt organizations, it will focus on several of the common questions that arise in applying these rules, and conclude with the author's view of some possible legislative and regulatory changes that warrant further examination. This paper is written purely from a tax practitioner's perspective. The broader constitutional and federal election law issues that are obviously implicated in any effort to regulate political speech and campaign finance practices are the subjects of other papers.

I. Federal Income Tax Rules Governing Political Campaign Activities by Tax-Exempt Organizations

Tax-exempt organizations are subject to varying restrictions on political campaign activities, depending on the category of exemption. Section 501(c)(3) organizations (commonly referred to as "charities") -- the category accorded the most favorable treatment[4] -- are subject to the most stringent restriction. They are flatly prohibited from intervening in political campaigns, and under a separate tax doctrine they cannot provide

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[4] Contributions to Section 501(c)(3) organizations are deductible as charitable contributions for income, estate and gift tax purposes. Sections 170, 2055 and 2522. While charities must report the names of contributors to the Internal Revenue Service (the "IRS") on Form 990, this information is not subject to public disclosure. These tax and disclosure advantages, plus the fact that corporations are permitted to contribute to Section 501(c)(3) organizations but not to political candidates, make Section 501(c)(3) organizations, in the word of one commentator, "enticements to politicians." Frances R. Hill, "Newt Gingrich and Oliver Twist: Charitable Contributions and Campaign Finance," 11 Exempt Organization Tax Review 43 at 44 (January 1995).

more than an insubstantial benefit to private parties, including political candidates and organizations. Charities classified as private foundations are subject to additional restrictions under Section 4945(f) with respect to certain voter registration activity. Finally, charities are subject to an excise tax penalty under Section 4955 on expenditures for political campaign activities, as are their managers under certain circumstances.

Section 501(c)(4) organizations do not receive the same tax benefits as Section 501(c)(3) organizations and are not subject to an absolute prohibition on political campaign activities.[5] They are permitted to engage in some political campaign activity, although not as their primary activity. In addition, they are subject to tax under Section 527 on the lesser of their political expenditures or their net investment income.

Section 527 is a category of exemption just for political organizations. These organizations are exempt from tax on funds that are expended for political activities, but are subject to tax on their net investment income and on any expenditures made for nonpolitical activities.[6]

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[5] Contributions to Section 501(c)(4) organizations are not deductible as charitable contributions. Donors are subject to the gift tax and estate tax on gifts and bequests to a Section 501(c)(4) organization.

[6] Contributions to Section 527 organizations are not deductible for income tax purposes and are not subject to the gift tax.

A. Section 501(c)(3) Organizations

1. Prohibition on Participation in Political Campaigns

Section 501(c)(3) provides exemption for nonprofit organizations which are organized and operated for certain designated purposes[7] and which do 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." The statute also provides that "no substantial part" of the activities of a Section 501(c)(3) organization may include "carrying on propaganda, or otherwise attempting, to influence legislation."

a. Legislative History

The language of the statute raises an obvious question: why is lobbying allowed so long as it is "no substantial part" of the organization's activities, while the prohibition on political campaign intervention is seemingly absolute? The legislative history of the statute sheds no light on this subject, although Congress clearly understands and approves of the dichotomy.[8] Interestingly, the lobbying restriction came first; it was added to the statute

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[7] Section 501(c)(3) lists eight separate purposes which will support exemption: religious, charitable, scientific, testing for public safety, literary, educational, fostering national or international amateur sports competition, and prevention of cruelty to children or animals. Organizations formed for any one or more of these purposes are generically referred to as "charitable."

[8] See, e.g., Subcommittee on Oversight of the Comm. on Ways and Means, 100th Cong., Report and Recommendations on Lobbying and Political Activities By Tax-Exempt Organizations 37 (Comm. Print 1987) (hereinafter referred to as the "Oversight Report").

in 1934.[9] The original legislative proposal would have denied exemption to organizations engaging in "partisan politics" as well as substantial lobbying activities.[10] The reference to "partisan politics" was deleted in conference, however, leaving only the lobbying restriction until 1954, when the prohibition against political campaign intervention "in support of" candidates was enacted.[11] Introduced in the form of a floor amendment by Lyndon Johnson, then Senate Minority Leader, the provision passed without discussion or debate, and has no explanatory legislative history.[12] In 1987, the statute was amended to add the parenthetical phrase "or in opposition to," making it clear that Section 501(c)(3) organizations can neither support nor oppose candidates for public office.[13]

The disparate treatment of lobbying and political campaign intervention activities has been the subject of considerable discussion over the years. Noting the lack of any explanation for the distinction in the legislative history, at least one commentator has argued that there is no less justification for permitting an "insubstantial" amount of political campaign intervention.[14] Using religious organizations as the exemplar, he has

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9 Oversight Report at 18.

10 Id. at 18-19.

11 Id. at 19.

12 Sen. Johnson reportedly introduced the amendment because he was distressed about the assistance provided by a charitable organization to his opponent in the 1954 primary election for his Senate seat. Bruce R. Hopkins, Charity, Advocacy and the Law 392 (1992).

13 Id. at 393.

14 D. Benson Tesdahl, "Intervention in Political Campaigns by Religious

(continued...)

argued that a charity's ability to impact public policy will be far greater if it is able to support the election of candidates whose views are synonymous with its own. After all, he observes -- no doubt correctly -- that

> helping candidates get elected to office is, in most cases, a more efficient way to affect a wide range of moral issues over a long period of time than is lobbying on an issue-by-issue basis.[15]

This commentator has advocated repealing the prohibition on political campaign activity altogether, or at least amending Section 501(c)(3) to permit charities to engage in insubstantial amounts of political campaign activity, possibly with the protection of a safe-harbor election similar to Section 501(h).[16] Although legislation to permit churches to engage in an insubstantial amount of political campaign activities has been introduced in the past, it has been given no serious consideration to date.[17]

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[14](...continued)
Organizations After the Pickle Hearings -- A Proposal for the 1990s," 4 Exempt Organization Tax Review 1165 at 1176 (November 1991). Such criticisms of the prohibition on campaign intervention are not new. See, e.g., Elias Clark, "The Limitation on Political Activities: A Discordant Note in the Law of Charities," 46 Va. L. Rev. 439 at 466 (1960) (describing the problems in applying the prohibition and proposing that the Treasury Department give more "flexible" interpretation to the rules).

[15] 4 Exempt Organization Tax Review at 1174.

[16] Id. at 1174-1175.

[17] See, e.g., H.R. 2910, 104th Cong. (1996), introduced by Reps. Crane and Rangel, which would have permitted churches to devote up to 5% of gross revenues to campaign activities for or against political candidates.

b. Definition of Terms

There are three key elements of the statutory prohibition on political campaign intervention under Section 501(c)(3). There must be a "candidate" who is seeking "public office," and the organization must "participate in, or intervene in" the candidate's political campaign. With the stakes so high -- one slip and a charity puts its exemption in jeopardy -- these terms need to be defined in a clear and straightforward manner. In at least some respects, however, they are not.

(1) Who is a "Candidate"?

Treasury Regulation section 1.501(c)(3)-1(c)(3)(iii) provides that a candidate is "any individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state or local." Under this definition, it is clear that a person who has announced his or her intention to seek election is a candidate. It seems likely, moreover, that an incumbent would -- at least presumptively -- be a candidate unless and until he or she declared an intention not to run for reelection.

But what does it mean to be "proposed by others"? In today's political climate, many public figures may be the subject of media speculation, whether occasional or rampant, about their possible candidacy. Even figures like General Colin Powell, whose public statements consistently and unequivocally denied any interest in entering the 1996 Presidential race, would seem to be "proposed by others" in the common sense use of the phrase. Indeed, the IRS has expressed the view that an individual may be considered a

candidate "even when the individual has announced an intention of not seeking election to the office."[18]

In its analysis of the political campaign intervention rules, prepared for hearings held in 1987 by the Subcommittee on Oversight of the Ways and Means Committee, the staff of the Joint Committee of Taxation observed that

> [c]lear standards do not exist for determining precisely at what point an individual becomes a candidate for purposes of the rule. On the one hand, once an individual declares his candidacy for a particular office, his status as a candidate is clear. On the other hand, the fact that an individual is a prominent political figure does not automatically make him a candidate, even if there is speculation regarding his possible future candidacy for particular offices.[19]

Nothing has happened to clarify this definition in the decade since the Joint Tax Committee's staff report in 1987. The IRS has not issued any precedential guidance on how to determine whether someone is a "candidate" for purposes of the prohibition on political campaign intervention, and the current regulations do not offer a workable standard by which charities may reliably judge whether an interaction with a potential candidate may put their tax exemption at risk.

The lack of a clear definition of who is a "candidate" has a chilling effect on all sorts of perfectly innocuous behavior. Take, for example, a Section 501(c)(3) "think tank" that engages in nonpartisan research on significant public policy issues. Assume the

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[18] Judith E. Kindell and John F. Reilly, "Election Year Issues," Exempt Organizations Continuing Professional Education Technical Instruction Program 400 at 407 (1992) (hereinafter referred to as "CPE Text").

[19] Staff of Joint Comm. on Taxation, 100th Cong., Lobbying and Political Activities of Tax-Exempt Organizations 14-15 (Joint Comm. Print 1987).

think tank wants to steer clear of any activity that might jeopardize its tax exemption. One of the think tank's fellows is a former elected official who writes and speaks on education reform and is regarded as a leading authority in the field. Some three years before the next Presidential election, her name begins to appear on various (rather long) lists of potential candidates. When asked about this, the fellow assures the think tank that she has no present intention to enter the race and has done nothing to organize a campaign.

Is the fellow a candidate for purposes of the prohibition on political campaign intervention under Section 501(c)(3)? Probably not, but it's impossible to say for sure. What should the think tank do? Probably just remind her of the constraints imposed on it under Section 501(c)(3) and ask her to report back if her intentions change. But is that enough? The think tank sees education shaping up to be a key issue in the next election and believes that the fellow could be a viable candidate if she chose to run. It worries that by continuing to provide a forum for the fellow's rather high profile activity, it may be viewed as advancing her potential candidacy. And the think tank knows that on audit, hindsight can be 20/20.

Moreover, the IRS is not the think tank's only concern. The lack of a clear standard will leave it vulnerable to third party challenges as well. The think tank is well aware that if the fellow decides to enter the race, the propriety of their relationship will be scrutinized by the press and fair game for challenge by the fellow's opponents, even if the think tank never hears a word from the IRS.

This example is not entirely hypothetical. It is a real question -- with dozens of variations -- that is asked time and again as Section 501(c)(3) organizations seek to make judgments about the types of relationships they may have with public figures who may be in the process of considering candidacy. Without clear rules, some organizations decide to play it safe and avoid relationships that have even a remote possibility of challenge. Others make reasonable judgments based on the facts at hand, document the basis for their determinations, and hope for the best. And, doubtless, there may be some that exploit the uncertainty of the law by engaging in activities under cover of "education" that are intended to advance the candidacy of particular persons. All of these courses of action have been allowed and will continue to flourish in the absence of a clear and workable definition of a "candidate."[20]

One obvious question is whether the definition of a "candidate" for Section 501(c)(3) purposes should be aligned with the definition that is used by the Federal Elections Commission (which declares that an individual becomes a candidate only after he or she has received campaign contributions or made expenditures of $5,000 or more)[21] or by the Federal Communications Commission (which requires a public announcement of

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[20] As discussed below, in 1987 Congress enacted Section 4955(d)(2) in response to the proliferation of Section 501(c)(3) organizations formed for the primary purpose of promoting the candidacy or potential candidacy of particular individuals. However, this provision is exceedingly narrow and would not reach the example described above.

[21] 11 C.F.R. § 100.3(a) (1997).

intention to run for office).[22] In the CPE Text, the IRS analyzed the purposes of these three regimes and concluded that neither the FEC nor the FCC definition should be used to determine whether an individual is a candidate for purposes of Section 501(c)(3).[23] Some commentators have urged the IRS to reconsider this position, pointing out that at the very least, anyone who is a candidate for FEC purposes should be considered a candidate for Section 501(c)(3) purposes.[24] That much seems clear, and it is surprising that the IRS has not said so in express terms. What is needed is some guidance about the converse. In the context of federal elections, when -- if ever -- should an individual who is not a candidate for FEC purposes be considered a candidate for Section 501(c)(3) purposes? And what comparable rules should apply in the context of state and local elections?

(2) What is a "Public Office"?

Although the IRS regulations under Section 501(c)(3) provide a definition of "candidate" -- albeit an inadequate one -- they contain no specific definition of "public office." Within the definition of "candidate," the regulations simply refer to "an elective public office, whether such office be national, State or local."[25] The IRS has interpreted

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22 47 C.F.R. § 73.1940(a)(1) (1997).

23 CPE Text at 408-409.

24 Gregory L. Colvin et al., "Commentary on Internal Revenue Service 1993 Exempt Organizations Continuing Professional Education Technical Instruction Program Article on 'Election Year Issues'," 11 Exempt Organization Tax Review 854 at 855, 859 (April 1995) (hereinafter referred to as "EO Comments").

25 Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii).

the term to encompass elective positions in political parties. In General Counsel Memorandum 39811 (June 30, 1989), the IRS held that the term "public office" includes a state precinct committeeman, where the position was created by statute, has a fixed term, is not occasional or contractual, and requires an oath of office. This IRS interpretation seems clearly correct, although it may have caught the organization at issue by surprise. All in all, the "public office" requirement has not generated the same degree of uncertainty as the "candidate" requirement, and it is likely that lingering uncertainties about what constitutes a "public office" -- if there are any -- would be resolved or at least fleshed out in the course of defining who is a candidate.

(3) What is "Intervention in a Political Campaign"?

Section 501(c)(3) defines participation in a political campaign as "including the publishing or distribution of statements."[26] The regulations offer little more in the way of guidance. Treasury Regulation section 1.501(c)(3)-1(c)(3)(3)(iii) provides that

> [a]ctivities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such a candidate (emphasis added).

The IRS interprets these underscored terms ("including" in the statute and "include, but are not limited to" in the regulations) to mean that campaign intervention encompasses not only a direct candidate endorsement but also activities falling short of that. For this reason, the IRS takes the position that it cannot adopt, for Section 501(c)(3)

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[26] Section 501(c)(3) (emphasis added).

purposes, "the express advocacy" standard set by the Supreme Court for determining the reach of the Federal Elections Campaign Act ("FECA") in Buckley v. Valeo.[27]

If a violation of the prohibition on campaign intervention can be based on something less than "express advocacy," what might that be?[28] The IRS has issued fewer than a dozen revenue rulings in this area (none in recent years), and those rulings -- along with the statute, regulations and a few court cases -- constitute virtually all of the precedential guidance on the subject.[29] While this guidance covers many aspects of the campaign intervention prohibition, it fails to address some that are quite significant. A brief analysis

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[27] CPE Text at 412-413 citing Buckley v. Valeo, 424 U.S. 1 at 77 (1976). In that case, the Supreme Court ruled that

> [t]he provision for disclosure by those who make independent contributions and expenditures, as narrowly construed to apply only (1) when they make contributions earmarked for political purposes or authorized or requested by a candidate or his agent to some person other than a candidate or political committee and (2) when they make an expenditure for a communication that expressly advocates the election or defeat of a clearly identified candidate is not unconstitutionally vague and does not constitute a prior restraint but is a reasonable and minimally restrictive method of furthering First Amendment values by public exposure of the federal election system. 424 U.S. at 4.

[28] The Oversight Report noted a few obvious examples, including making or soliciting campaign contributions, providing publicity or volunteer assistance to a candidate, and paying expenses of a political candidate. Oversight Report at 23.

[29] The IRS has also issued a number of private letter rulings and general counsel memoranda addressing the prohibition on campaign intervention. While these documents may be useful to show how the IRS interprets certain aspects of the campaign intervention prohibition, they have no precedential effect. § 6110(j)(3). Moreover, because private letter rulings generally have extensive deletions to protect taxpayer confidentiality, they may easily convey an incomplete or inaccurate impression as to the IRS resolution of particular questions. For these reasons, this paper includes only limited citations to private letter rulings and general counsel memoranda.

of the issues covered in these rulings and cases is helpful to show where some of the clear boundaries do -- and do not -- exist.

(a) Treatment of Nonpartisan Candidate Endorsements and the Relevance of Intent

Over three decades ago, in Revenue Ruling 67-71,[30] the IRS first addressed a subject that remains at the heart of the controversy over the campaign intervention prohibition. This is the intersection of "education" and "politics" -- whether an activity that is conducted in a nonpartisan manner and intended to serve educational purposes may nevertheless violate the campaign intervention prohibition. The ruling involves an organization created to improve a public educational system, which conducts an objective review of the qualifications of school board candidates and announces the names of those it considers most qualified. The IRS concludes that the organization's activities constitute participation in a political campaign, "even though its process of selection may have been completely objective and unbiased and was intended primarily to educate and inform the public about the candidates."[31]

Revenue Ruling 67-71 was cited with approval in Association of the Bar of the City of New York v. Commissioner.[32] That case involved the Bar's practice of rating candidates for elective judgeships as "approved," "not approved," or "approved as highly qualified." The Bar disseminated such ratings to the public for the purpose of promoting

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30 1967-1 C.B. 125.

31 Id. at 125.

32 858 F.2d 876 at 881 (2d Cir. 1988).

the election of qualified candidates and "prevent[ing] political considerations from outweighing judicial fitness in the selection of . . . [candidates for judicial office]."[33] Although obviously sympathetic to the educational objectives sought to be served by the Bar and the nonpartisan manner in which the activity was conducted, the Second Circuit nevertheless found the prohibition on campaign intervention to be absolute and the rating activity to be in violation, observing that

> [a] candidate who receives a "not qualified" rating will derive little comfort from the fact that the rating may have been made in a nonpartisan manner.[34]

Revenue Ruling 67-71 and the Association of the Bar of the City of New York both involved organizations whose motivation for conducting the impermissible political campaign activity was to accomplish certain nonpartisan educational objectives. Having a "good" (i.e., nonpartisan) motive was not, however, accepted by the IRS as justification for the impermissible campaign intervention, and the IRS cited those authorities as legal support for the following question and answer in the CPE Text:

> Question: Does the motivation of an organization determine whether the political campaign prohibition has been violated?
>
> Answer: No, the motivation of an organization is irrelevant when determining whether the political campaign prohibition has been violated.[35]

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[33] Id. at 878.

[34] Id. at 880.

[35] CPE Text at 415.

While the statement in the CPE Text apparently was intended to put to rest the use of "good motives" as a defense to violation of the prohibition on campaign intervention, it has -- ironically -- fueled a new debate as to whether "bad motives" are similarly irrelevant. For these purposes, having a "good motive" means that the activity is undertaken for a demonstrably nonpartisan educational purpose. Having a "bad motive" means that the activity, although educational in nature, also has a partisan political purpose. Since the determination as to whether an activity constitutes a prohibited campaign intervention is based on a "facts and circumstances" analysis,[36] it seems unlikely that the IRS would choose to disregard evidence showing that the activity was intended to achieve political campaign-related objectives. Indeed, on a common sense level, it is hard to imagine what "facts and circumstances" could be more relevant than those establishing that an activity was intended and designed for partisan political purposes.

Pointing to the language in the CPE Text, however, some practitioners have argued that evidence of partisan political motives should be irrelevant to a determination as to whether a particular activity violates the campaign intervention prohibition.[37] Others have reached the opposite conclusion, pointing out that "reliance on intent . . . is consistent with the general tax principle of substance over form,"[38] and that "[o]bjective

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[36] CPE Text at 410.

[37] See, e.g., Jeffrey Yablon and Edward D. Coleman, "Intent is Not Relevant in Distinguishing Between Education and Politics," 9 Journal of Taxation of Exempt Organizations 156 at 157 (January/February 1998).

[38] Frances R. Hill, "The Role of Intent in Distinguishing Between Education (continued...)

manifestations of political purpose, not mere intimations of subjective intent, should violate and do violate Section 501(c)(3)."[39] With the publication of these articles, the IRS is on notice as to the differing interpretations of the statement in the CPE Text. In the author's view, it now has an obligation to be explicit about whether it meant to suggest that an organization's partisan political motivation is irrelevant in determining whether ambiguous behavior constitutes prohibited campaign intervention.

(b) Attribution of Individual Activities to Section 501(c)(3) Organizations

Another question at the intersection of education (or religion) and politics concerns under what circumstances the political campaign activities of an individual will be attributed to a Section 501(c)(3) organization. The IRS first addressed this issue in Revenue Ruling 72-513.[40] The ruling involves a university which provides facilities and faculty advisors for a student-run newspaper. Neither the university nor the faculty

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[38](...continued)
and Politics," 9 Taxation of Exempt Organizations 9 (July/August 1997). See also Frances R. Hill, "Corporate Philanthropy and Campaign Finance: Exempt Organizations as Corporate-Candidate Conduits," 41 N.Y.L. Sch. L. Rev. 881 (1997):

> The determination of whether an activity constitutes impermissible political activity is based on the intent or purposes of those engaged in the activity, not on an analysis of any inherent qualities of the activity. Intent is deciphered from the statements of the participants or from any analysis of the manner in which the activities is conducted. 41 N.Y.L. Sch. L. Rev. at 928.

[39] Gregory L. Colvin, "Can a Section 501(c)(3) Organization Have a Political Purpose?" 10 Journal of Taxation of Exempt Organizations 40 (July/August 1998).

[40] 1972-2 C.B. 246.

advisors exercise any control or direction over the editorial policies of the newspaper, and the editorial pages include a statement that "the views expressed are those of the student editors and not those of the university." The newspaper, in what the IRS recognizes as "customary journalistic manner," takes positions on pending or proposed legislation and candidates for political office. After reviewing the educational link between the purposes of the university and the student newspaper, the IRS concludes that the student editorials should not be considered acts of the university, and therefore that the activity does not violate the prohibition against political campaign intervention.

The position taken by the IRS in this ruling feels instinctively right. Why should a university's tax exemption be in jeopardy because its students -- acting on their own behalf and not on behalf of the university -- decide to endorse candidates for office in the school newspaper? Where the university simply permits such activity, without attempting to control or direct it, there should be no attribution.[41] It is possible that the IRS may have regarded Revenue Ruling 72-513 as a close case, however, and that its issuance was aided, at least to some extent, by the fact that the voting age at the time was 21 -- limiting somewhat the potential electoral impact of any endorsement in a student newspaper.

The issue of whether an individual's political campaign activity, including candidate endorsements, should be attributed to a Section 501(c)(3) organization arises most commonly in the context of religious organizations, where the constitutional issues are

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[41] For a discussion of the impact of the campaign intervention prohibition in the context of activities within the college and university community, see Theodore L. Garrett, "Federal Tax Limitations on Political Activities of Public Interest and Educational Organizations," 59 Geo. L. J. 561 (1971).

most sensitive. As elections draw near, candidate visits to churches become a regular part of the political campaign strategy, the endorsements of religious leaders are sought and widely disseminated,[42] and the IRS is faced with the difficult and unenviable task of deciding whether to countenance what appears to be implicit -- if not downright explicit -- involvement by churches in political campaigns. The special protections accorded to churches under the tax laws make it difficult for the IRS to initiate church audits; the law essentially requires the IRS to have specific evidence of a violation, and does not permit it to audit a church for purposes of determining whether or not some ambiguous behavior might be sufficient to give rise to a violation.[43] And the vastly different relationships that exist between religious leaders and the churches they serve, based on different denominational structures, add even more complexity as the IRS seeks to determine whether the action is that of a religious leader or that of the church.

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[42] See, e.g., James L. Guth and Lyman A. Kellstedt, "The New Bully Pulpits," 2 Books and Culture 8 (March/April 1996). The authors report that, according to surveys of pastors of churches in the Southern Baptist Convention, during 1992 some 85% of fundamentalist pastors endorsed a candidate, as did some 63% of the conservative pastors and some 49% of moderate pastors.

[43] Section 7611 provides that a church audit cannot be commenced unless the IRS Regional Commissioner has a "reasonable belief," based on facts and circumstances recorded in writing, that the church is not entitled to exemption. An example of a recent church audit involved the Church of Pierce Creek, which was audited because it placed anti-Clinton advertisements in national newspapers four days before the 1992 Presidential election. The advertisements warned that the positions held by then-Gov. Clinton on abortion and homosexuality were contrary to the biblical views of the Church. On audit, the IRS proposed revocation of the Church's exemption. The Church filed a declaratory judgment petition in the United States District Court for the District of Columbia, where the case is now pending. Branch Ministries, et al. v. Commissioner, No. 1:95-CV00724 (D.C. September 25, 1998).

While we know very little about what the IRS does in these cases, there have been a few press releases issued pursuant to the terms of closing agreements which evidence some IRS enforcement activity in this area and indicate that, in appropriate cases, the IRS is prepared to hold churches accountable for candidate endorsements made by their religious leaders.[44] Given the level of involvement by churches in matters of public policy, including issues such as abortion which are often regarded as "litmus tests" by which candidates are identified, there is a need for precedential guidance on how religious leaders may express their individual views without causing their churches to be at risk for violating the campaign intervention.[45] Such guidance could also be applicable to other types of issue-oriented Section 501(c)(3) organizations whose leaders are commonly identified with the causes of their organizations.

(c) Voter Education Activities: Voter Guides and Incumbent Voting Records

The treatment of voter education activities is one of the most important issues under the campaign intervention prohibition. This issue is addressed -- but by no means

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[44] See CPE Text at 435-436. In 1991, Jimmy Swaggert Ministries issued a press release about a closing agreement it entered into with the IRS concerning Jimmy Swaggert's endorsement of Pat Robertson's candidacy for President at a religious service and in his column in the organization's magazine. Paul Streckfus, "Swaggert Settlement Drawing Comments," 5 Exempt Organization Tax Review 205 (February 1992). Other religious organizations that have lost their tax exemption for engaging in political campaign intervention include Jerry Falwell's Old Time Gospel Hour, see "Statement of Jerry Falwell Regarding Closing Agreement," 7 Exempt Organization Tax Review 876 (May 1993); and Pat Robertson's Christian Broadcasting Network, see "News Release, The Christian Broadcasting Network," 98 TNT 55-78 (March 16, 1998).

[45] See EO Comments at 856.

resolved -- in two rulings that are nearly two decades old, Revenue Ruling 78-248,[46] and Revenue Ruling 80-282.[47] The rulings emphasize that the applicable test is one of "facts and circumstances," requiring an examination of whether the activity reflects any "bias or preference" with respect to the views of any candidate or group of candidates. The rulings are, however, exceedingly narrow in scope and leave uncertain the propriety of many types of voter education activities.

Revenue Ruling 78-248 holds that permissible voter education includes the annual dissemination, without editorial comment, of a compilation of the voting records of members of Congress. It similarly includes the dissemination, again without editorial comment, of responses to questionnaires sent to all candidates for a particular office, asking for their positions on a wide variety of issues selected on the basis of their interest to the electorate as a whole. Examples of impermissible voter education activity include the dissemination of candidate questionnaires which "evidence a bias" as to certain issues, as well as the dissemination of voting records of incumbents on a narrow range of issues. In the latter case, the ruling concludes that the organization's "emphasis on one area of concern indicates that its purpose is not nonpartisan voter education."[48]

Revenue Ruling 80-282 broadens the prior ruling only slightly to permit dissemination of the voting records of incumbents on selected issues, where the distribution is

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[46] 1978-1 C.B. 154.

[47] 1980-2 C.B. 178.

[48] 1978-1 C.B. at 155.

limited to members of an organization, is made shortly after the close of each legislative session, does not identify which incumbents may be candidates for reelection, and contains a caveat about judging the qualifications of an incumbent based on a few selected votes. Where all of these criteria are met, the IRS concludes that, although the form and content of the publication are not neutral because of the focus on selected issues, the existence of other factors are sufficient to establish that the dissemination should not be considered participation in a political campaign.

Taken together, Revenue Rulings 78-248 and 80-282 carve out only a narrow category of voter education activities that are explicitly held to be permissible under Section 501(c)(3). Many other types of voter education activities simply are not addressed. For example, what if a Section 501(c)(3) organization compiles voter guides based on its own research about candidates rather than by using candidate questionnaires? What happens if a questionnaire is used but some candidates do not respond? What is considered to be a narrow range of issues? What if there is a crowded field of candidates but only a few have any realistic prospect of being elected -- is an organization allowed to target its voter education activities to a more limited field of those with some possible chance of being elected? And finally, what types of voter education activities can an issue-oriented organization direct to its members? For each of these questions, it should be possible to define boundaries for permissible activities that go beyond the four corners of the existing precedential guidance.

Commentators have urged the IRS to provide more definitive and useful guidance on voter education activities, including voter guides and candidate questionnaires.[49] There is a similar lack of guidance on the boundaries of permissible voter registration activities and "get out the vote" efforts. While the lack of such guidance is likely to have a chilling effect on some Section 501(c)(3) organizations, it is just as likely to provide an opportunity for others to pursue more aggressive strategies.

A recent example of the diversity of opinion that can result in the absence of adequate guidance may be found in the widely-publicized controversy over whether churches' distribution of the voter guides prepared by the Christian Coalition (which claims exemption under Section 501(c)(4)) for the 1996 election constituted impermissible campaign intervention. After questions were raised about whether such voter guides could be viewed as evidencing a bias for certain candidates, counsel for the Christian Coalition issued a memorandum that pastors "should have no concern" that the dissemination of the voter guides might constitute impermissible campaign intervention.[50] Counsel for Americans United for Separation of Church and State responded with another memorandum, warning that churches should indeed be concerned about the dissemination of such guides because they may constitute an implied endorsement of candidates whose positions

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[49] See, e.g., EO Comments at 862. Individual members of the Subcommittee on Political & Lobbying Organizations & Activities of the ABA Tax Section's Exempt Organizations Committee have prepared a thoughtful analysis of additional guidance that is needed with respect to the preparation and dissemination of voter guides. Unpublished draft position paper dated July 24, 1998.

[50] Fred Stokeld, "Christian Coalition Voter Guides Raise 501(c)(3) Question," 15 Exempt Organization Tax Review 347 at 348 (December 1996).

track those of the organization.[51] This diversity of opinion is troubling and reinforces the need for additional guidance on the subject of voter education, with particular focus on the issue of voter guides.[52]

(d) Relationships With Political Action Committees

Although some categories of tax-exempt organizations are permitted to establish or support political action committees ("PACs"),[53] Section 501(c)(3) organizations are not. When Section 527 (discussed below) was enacted, the legislative history provided that "this provision is not intended to affect in any way the prohibition against certain exempt organizations (e.g., Section 501(c)(3)) engaging in 'electioneering . . . .'"[54] Treasury Regulation section 1.527-6(g) reflects this congressional intent:

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[51] Milton Cerny and Albert G. Lauber, "Urgent Memorandum for Churches Concerning Distribution of 'Voter Guides,'" 15 Exempt Organization Tax Review 179 (November 1996). The authors recently issued an updated memorandum in connection with the 1998 Congressional elections. Milton Cerny and Albert G. Lauber, "Urgent Memorandum for Churches Concerning Distribution of 'Voter Guides' In 1998 Congressional Elections," Tax Notes Today (September 18, 1998).

[52] For an interesting three-part series of articles on voter guides and campaign intervention, see 1 Paul Streckfus' EO Tax Journal, "In-Depth Focus on Campaign Intervention," (November 1996); "In-Depth Focus on Campaign Intervention - Part II," (December 1996); and In-Depth Focus on Campaign Intervention - Part III," (January 1997). See also, Deirdre Dessingue Halloran and Kevin M. Kearney, "Federal Tax Code Restrictions on Church Political Activities," 38 Catholic Lawyer 105 (1998), in which Ms. Halloran explains the rules governing the dissemination of voter guides and Mr. Kearney relates his experience representing a church during an IRS audit challenging its distribution of a church bulletin urging congregants to vote in a school board election.

[53] For example, Section 501(c)(4) organizations are permitted to establish and/or support PACs. If they provide financial support to a PAC, they are subject to tax, under Section 527, on the lesser of their net investment income or their expenditures to support the PAC.

[54] S. Rep. No. 93-1357 (1974), reprinted in 1975-1 C.B. 517 at 534.

> Section 527(f) and this section do not sanction the intervention in any political campaign by an organization described in section 501(c) if such activity is inconsistent with its exempt status under section 501(c). For example, an organization described in section 501(c)(3) is precluded from engaging in any political campaign activities. The fact that section 527 imposes a tax on the exempt function income (as defined in section 1.527-2(c)) expenditures of section 501(c) organizations and permits such organizations to establish separate segregated funds to engage in campaign activities does not sanction the participation in these activities by section 501(c)(3) organizations.

The IRS has taken a broad interpretation of the prohibition against the support of PACs by Section 501(c)(3) organizations.[55] While the use of a Section 501(c)(3)'s facilities, personnel, or other financial resources for the benefit of a PAC clearly is impermissible, the IRS has expressed the view that the prohibition does not stop there. In its CPE Manual, the IRS states that "[a]n IRC 501(c)(3) organization's resources include intangible assets, such as its goodwill, that may not be used to support the political campaign activities of another organization."[56] Some practitioners have interpreted this provision to prohibit a charity from allowing its named to be used by a PAC, even if the charity provides no financial support or assistance; by allowing a PAC to use its name, they argue, the charity implies to its employees and to the public that it endorses the activity of the PAC.[57]

In one of the most thorough and provocative articles on political activities by Section 501(c)(3) organizations, one commentator has proposed that Section 501(c)(3)

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55 CPE Text at 438-40.

56 Id. at 440.

57 EO Comments at 871.

organizations be allowed to establish PACs.[58] Adapting the model approved by the Supreme Court in Regan v. Taxation With Representation,[59] Professor Chisolm has advocated allowing Section 501(c)(3) organizations to conduct campaign-related activity through a PAC that is structurally and financially separate. In her view,

> [c]areful structural and financial separation, along with clear disclosure of organizational relationships, would entirely resolve whatever uneasiness we might feel about spending one taxpayer's money to promote another's political preferences or about making government expenditures, even in the most indirect manner, for the conduct of political contests.[60]

As part of this proposal, Professor Chisolm recognizes the need to amend the regulations under Section 527 (discussed below) so that Section 501(c)(3) organizations would be subject to tax on amounts expended to support the administrative and solicitation costs of the PAC. This would ensure that the funds used to pay the expenses of the PAC are made from after-tax dollars, putting Section 501(c)(3) organizations that have PACs on a level playing field with corporations and with other categories of exempt organizations.[61] Alternatively, she suggests that Section 501(c)(3) organizations could be prohibited from making expenditures to support the administrative and solicitation costs

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[58] Laura Brown Chisolm, "Politics and Charity: A Proposal for Peaceful Coexistence," 58 Geo. Wash. L. Rev. 308 (1990).

[59] 461 U.S. 540 (1983). In Taxation With Representation, the Supreme Court holds that a Section 501(c)(3) organization is permitted to conduct legislative activities through a related Section 501(c)(4) as long as there is appropriate financial separation between the organizations.

[60] Chisolm at 352.

[61] Chisolm at 355.

of the PAC, but allowed to be identified as the PAC sponsor, to share staff and facilities, and to control the agenda and activities of the PAC.[62]

In the decade since Professor Chisolm's article, there has been no occasion for Congress to give serious consideration to her proposal. What has happened, however, is a dramatic increase in the use of "soft dollars" by political parties to support allegedly nonpartisan activities by tax-exempt organizations, such as voter registration activities conducted by Section 501(c)(3) organizations.[63] This raises a practical question about the consequences of Professor Chisolm's proposal. Although she expressed the view that "there would not likely be any great rush"[64] of Section 501(c)(3) organizations to establish PACs if her proposal were enacted, she did not speculate on whether the converse might occur -- whether candidates or political parties would themselves be the impetus for the establishment of PACs by Section 501(c)(3)s. Right now the tax laws give Section 501(c)(3) organizations a convenient basis to turn away fundraising appeals from politicians, but Professor Chisolm's proposal would leave them fair game. This could be a particularly sensitive problem for Section 501(c)(3) organizations that regularly engage in

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[62] Chisolm at 358.

[63] For an interesting discussion of this subject, see Milton Cerny, "Current Issues Involving Lobbying and Political Activities as They Affect Tax Exempt Organizations," 20 Exempt Organization Tax Review 441 (June 1998). See also Jill Abramson and Leslie Wayne, "Both Parties Were Assisted By Nonprofit Groups in 1996," N.Y. Times, Oct. 24, 1997 at 1.

[64] Chisolm at 365.

lobbying; they might be tempting targets for candidates who, having helped the charities with their legislative issues, now seek support in tight races.

2. Restrictions on Private Foundation Grants for Voter Registration Under Section 4945(f)

In addition to the absolute prohibition on campaign intervention under Section 501(c)(3), private foundations are subject to restrictions, under Section 4945(f), on grants made for voter registration purposes. Enacted in 1969 in reaction to reported instances of private foundation-funded voter registration campaigns that were conducted in limited geographic areas and appeared to favor particular candidates,[65] the provision was not intended to apply to other voter registration activities conducted by public charities.[66]

Under Section 4945(f), a private foundation is permitted to make grants that are earmarked for voter registration purposes only if the grantee is a Section 501(c)(3) organization that meets the following requirements:

- it spends at least 85% of its income on direct charitable activity;
- it meets three support tests: at least 85% of its total support (excluding investment income) is from other exempt organizations, the public or governmental units; not more than 25% is from any one exempt organization; and not more than 50% is investment income;
- the voter registration activity is nonpartisan, conducted in five or more states, and not limited to one election period; and

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[65] General Explanation of the Tax Reform Act of 1969, 91st Cong., 2d Sess. (1970), 9 Tax Management (BNA) § 4945.13.

[66] See Treas. Dept. Release K-87 (May 11, 1969), cited in Thomas A. Troyer and Vivian L. Cavalieri, "Voter Registration and Education," The Funders' Committee for Citizen Participation 22 (1985).

- it does not accept contributions that are limited to use in specified states or election periods (regardless of whether such contributions come from private foundations or from other sources).[67]

Most of these requirements are purely mechanical. It is important to note, however, that although Section 4945(f) prohibits geographic and temporal concentration of voter registration activities, there is no limit on the organization's ability to target its efforts to a particular class of potential voters, so long as the activity is conducted in a nonpartisan manner. Accordingly, the IRS allows Section 501(c)(3) organizations to direct nonpartisan voter registration activities to disadvantaged or underrepresented classes.[68] Commentators have called for the IRS to issue guidance on how to distinguish between permissible and impermissible voter registration targeting criteria, noting that this is an area "with significant abuse potential if targeting occurs on issue or party lines."[69]

3. Excise Tax Penalties Under Section 4955

Section 4955, added to the Code in 1987, was enacted following two days of hearings by the Subcommittee on Oversight of the Committee on Ways and Means in response to numerous reports of charities' intervention in political campaigns.[70] Modeled

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[67] The IRS has issued a number of private letter rulings that voter registration organizations meet the requirements of Section 4945(f). See, e.g., Priv. Ltr. Rul. 9223050 (Mar. 10, 1992); Priv. Ltr. Rul. 8620005 (Feb. 24, 1986); Priv. Ltr. Rul. 8541111 (July 19, 1985); Priv. Ltr. Rul. 8518066 (Feb. 6, 1985); Priv. Ltr. Rul. 8442074 (July 18, 1984).

[68] See Priv. Ltr. Rul. 9223050 (Mar. 10, 1992) (approving voter registration effort directed to homeless persons).

[69] EO Comments at 863.

[70] For an interesting article describing the use of Section 501(c)(3)

(continued...)

after the excise tax penalty scheme for private foundations under Section 4945, it imposes an excise tax on charities that make expenditures in violation of the prohibition on campaign intervention, and on organization managers that knowingly approve the making of such expenditures.

a. Legislative History

The legislative history of Section 4955 indicates that the provision was enacted for several reasons. First, there was a determination that the excise tax penalty scheme imposed on private foundations that make political expenditures has been effective and should be extended to public charities. Second, there was a desire to provide an intermediate sanction, short of revocation of tax exemption, that could be used by the IRS in circumstances where revocation would be disproportionate to the violation. The legislative history provides, as an example of such a case, a situation

> where the expenditure was unintentional and involved only a small amount and where the organization subsequently had adopted procedures to assure that similar expenditures would not be made in the future . . . .[71]

Finally, while revocation of exemption may be too harsh a penalty in the situation described above, it may -- at the other extreme -- be ineffective as a deterrent to an organization that is prepared to cease operations after making an improper political

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[70](...continued)
organizations by politicians that led to the enactment of Section 4955, see Laura Brown Chisolm, "Sinking the Think Tanks Upstream: The Use and Misuse of Tax Exemption Law to Address the Use and Misuse of Tax-Exempt Organizations by Politicians," 51 U. Pitt. L. Rev. 577 (1990).

[71] H.R. Conf. Rep. No. 100-391 at 1623-24 (1987).

campaign expenditure. The legislative history indicates that Section 4955 is intended to address this problem by providing for the imposition of a penalty on the organization manager who approved the improper expenditure. [72] Finally, the legislative history reflects an intention to penalize certain expenditures made by charities that are formed or availed to promote the candidacy or potential candidacy of particular individuals.[73]

The latter provision was the only controversial aspect of Section 4955. The original recommendation by the Oversight Subcommittee would have treated certain amounts paid during the year preceding a candidate's declaration of candidacy or formation of an exploratory committee as "political expenditures" that would be subject to tax. In addition, the Oversight Subcommittee recommended that consideration be given to the imposition of excise tax penalties directly on the candidate where he or she "encouraged the prohibited expenditure and knowingly accepted it."[74] As introduced, however, the prohibition on candidate-related expenditures would have been applicable only where the organization was formed, or availed of "substantially," for purposes of promoting an individual's candidacy; the version that was enacted changed the term "substantially" to "primarily." The legislative history further weakened the potential applicability of the provision by requiring a showing that the candidate or prospective

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72 Id. at 1625-1626.

73 Id. at 1627.

74 Oversight Report at 45.

candidate has "continuing, substantial involvement in the day-to-day operations or management of the organization."[75]

b. Operation of Section 4955

Section 4955(a)(1) imposes a 10% first-tier excise tax on charities that make "political expenditures," and a 100 second-tier tax if the expenditure is not corrected within the applicable correction period. Section 4955(a)(2) imposes a 2 1/2% excise tax, not to exceed $5,000, on organization managers who knowingly approve the making of such political expenditures, and a 50% second-tier tax, not to exceed $10,000, if the expenditure is not corrected within the applicable period. The first-tier penalty may be abated under Section 4962 if the organization can show that the expenditure was due to reasonable cause and not to willful neglect.

Section 4955(d)(1) generally defines a political expenditure as an amount paid or incurred in connection with any participation or intervention in any political campaign -- using the same definition contained in Section 501(c)(3). And, as noted, Section 4955(d)(2) adds another category of "political expenditures" that is applicable only in the case of an organization that is "formed primarily" to support the candidacy or potential candidacy of a particular person, or is "effectively controlled" by the candidate and is availed of primarily for purposes of supporting his or her candidacy. For such organizations, the term also includes expenditures for amounts paid to such person for travel or speeches, expenses of conducting polls, surveys or research for such person, advertising,

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[75] H.R. Conf. Rep. No. 100-495 at 1261 (1987).

publicity or fundraising expenses for such person, or any other expense that "has the primary effect of promoting public recognition, or otherwise primarily accruing to the benefit of, such individual."

The IRS issued final regulations under Section 4955 in 1995, nearly a decade after the provision was enacted. Those regulations are quite short and add virtually nothing to the statute and legislative history.[76] Rather than trying to provide additional guidance as to what may constitute a "political expenditure" for purposes of the general definition under Section 4955(d)(1), the regulations duck the subject altogether by providing simply that

> [a]ny expenditure that would cause an organization that makes the expenditure to be classified as an action organization by reason of [Treasury Regulation section] 1.501(c)(3)-1(c)(3)(iii) . . . is a political expenditure within the meaning of Section 4955(d)(1).[77]

The regulations are no more helpful in interpreting the statutory provisions for candidate-controlled charities in Section 4955(d)(2). They contain, in fact, even less guidance than the legislative history, which may well be a reflection of the IRS' discomfort with that provision. After all, how could an organization that is primarily formed or availed of for the purpose of promoting an individual's candidacy possibly qualify for exemption under Section 501(c)(3) in the first place, a result that might be inferred by the

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[76] In this respect, the regulations stand in sharp contrast to the regulations issued under Sections 501(h) and 4911, governing the lobbying election by public charities.

[77] Treas. Reg. § 53.4955-8(c)(1).

existence of this provision? The legislative history fails to address this issue, which may have been lost in the watering-down process. As one commentator has noted,

> [o]n its face, the language of Section 4955(d)(2) appears to apply to organizations that could never qualify for exempt status [under Section 501(c)(3)], except in the case of an organization formed for exempt purposes that subsequently comes under the effective control of a candidate or potential candidate and is then used to promote that person's candidacy.[78]

In considering the treatment of candidate-controlled charities under Section 4955(d)(2), one cannot help but note the contrast with the approach recently taken by Congress in connection with the enactment of Section 4958. That provision imposes a similar type of two-tier excise tax penalty with respect to expenditures by a Section 501(c)(3) or (4) organization that violate the inurement prohibition. It, like the campaign intervention prohibition, is absolute. And Section 4958, like Section 4955, is intended to provide the IRS with an intermediate sanction -- short of revocation -- as a tool to address violations of the absolute prohibition. However, in the case of Section 4958, Congress had no qualms about imposing the excise tax penalty on the party benefitting from the improper expenditure rather than on the charity making it. And Congress further sought to protect the charity from financial misuse by requiring the party receiving the improper benefit to make it whole for the impermissible expenditure. It is difficult to see a policy justification for protecting a charity against depletion of its resources as a result of inurement but not as a result of candidate-directed political campaign intervention.

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[78] Frances R. Hill and Barbara L. Kirschten, Federal and State Taxation of Exempt Organizations at 2-111 (1994).

4. Termination Assessments Under Section 6852; Injunctions Under Section 7409

When Congress enacted Section 4955 in 1987, it also gave the IRS two extraordinary new enforcement tools for Section 501(c)(3) organizations that engage in willful and flagrant violations of the prohibition on political campaign intervention. These provisions, which are intended to enable the IRS to move quickly to put an end to violations, authorize the IRS to make a "termination assessment" or to obtain an injunction against continued violations.

a. Termination Assessment

Section 6852 authorizes the IRS to make a "termination assessment" against a Section 501(c)(3) organization that willfully and flagrantly violates the political campaign prohibition. Under Treasury Regulation section 301.6852-1(a), the termination assessment must be authorized by the District Director, and may only be made if the flagrant violation results in revocation of the organization's exempt status. Any tax liability becomes immediately due and payable; after the notice and demand is sent to the organization, it is required to pay the assessment within ten days, regardless of the filing of an administrative appeal or of a court petition. And unless the organization posts a bond, enforced collection action may proceed after the ten-day payment period. There is no evidence that the IRS has ever invoked the termination assessment procedures.

b. Injunction

Section 7409 authorizes the IRS to seek an injunction against a Section 501(c)(3) organization that is flagrantly violating the political campaign prohibition. Under

Treasury Regulation section 301.7409-1(a), the Assistant Commissioner (Employee Plans and Exempt Organizations) must conclude that the organization has engaged in flagrant political intervention and is likely to continue to engage in such activity. The Assistant Commissioner must notify the organization of the facts on which the conclusion was made; the organization then has ten days to respond by either agreeing to cease the political intervention or demonstrating that it did not engage in such intervention. If the organization fails to respond within the ten-day period or fails to refute the IRS's evidence of flagrant political intervention, the Commissioner must personally determine whether to forward a recommendation to the Department of Justice that an injunction under Section 7409 be sought.[79] The Commissioner may also request the court action to include any other remedy that is appropriate to ensure the preservation of the Section 501(c)(3) organization's assets.[80] There is no evidence that the IRS has ever sought an injunction under Section 7409.

5. Restrictions on Private Benefit

In addition to the absolute prohibition on campaign intervention, Section 501(c)(3) contains another form of restriction on the provision of benefits to candidates, political parties or PACs. Section 501(c)(3) requires, as a separate criterion for exemption, that an organization be organized and operated exclusively for charitable purposes. Treasury

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79 Treas. Reg. § 301.7409-1(b).

80 Id.

Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization does not meet this requirement

> unless it serves a public rather than a private interest. Thus . . . it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

The purpose of the "private benefit" restriction is to ensure that the favorable tax benefits accorded to Section 501(c)(3) organizations are reserved for organizations that are formed to serve public and not private interests. Unlike the restriction on political campaign intervention, the private benefit restriction is not absolute. Treasury Regulation section 1.501(c)(3)-1(c)(1) further explains the application of the private benefit restriction:

> An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

The regulations and cases applying them make it clear that the private benefit test focuses on the purpose or purposes served by an organization's activities, and not on the nature of the activities themselves.[81] Where an organization's activities serve more than one purpose, each purpose must be separately examined to determine whether it is private in nature and, if so, whether it is more than insubstantial.[82]

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81 See, e.g., B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978).

82 See, e.g., Christian Manner International v. Commissioner, 71 T.C. 661 (continued...)

The leading case on the application of the private benefit prohibition in the context of an organization whose activities served both exempt and nonexempt purposes is Better Business Bureau of Washington, D.C., Inc. v. United States.[83] Better Business Bureau was a nonprofit organization formed to educate the public about fraudulent business practices, to elevate business standards, and to educate consumers to be intelligent buyers. The Court did not question the exempt purpose of these activities. The Court found, however, that the organization was "animated" by the purpose of promoting a profitable business community, and that such business purpose was both nonexempt and more than insubstantial. The Court denied exemption, stating that

> in order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes.[84]

Many of the cases interpreting the private benefit prohibition involve private benefits that are provided in a commercial context -- as in the Better Business Bureau case. Impermissible private benefit need not be commercial in nature, however, and courts have applied the private benefit doctrine to deny exemption under Section 501(c)(3) to organizations that have conferred more than an insubstantial private benefit on political candidates, parties and/or organizations. The leading case is American Campaign

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[82](...continued)
(1979).

[83] 326 U.S. 279 (1945).

[84] Id. at 283.

Academy v. Commissioner.[85] That case involved an organization formed for the purpose of operating a school to train people to work in political campaigns. The school was an outgrowth of programs once run by the National Republican Congressional Committee, and had a number of other direct and indirect connections to Republican organizations.

In the opinion, Judge Nims wrote that the operational test of Treasury Regulation section 1.501(c)(3)-1(c)(1) probes to ascertain "the actual purpose to which an organization's activities [are directed] and not the nature of the activities or the organization's statement of purpose."[86] This, he explained, involves a factual analysis of "what an organization's purposes are and what purposes its activities support," and requires looking "beyond the four corners of the organization's charter to discover 'the actual objects motivating the organization'. . . ."[87] Finding that the Academy conducted its educational activities "with the partisan objective of benefiting Republican candidates and entities,"[88] and that the benefits conferred on such parties were not insubstantial, Judge Nims upheld the IRS' denial of exemption to the organization.[89] He noted, however, that the result might have been different if the record had established that "the Academy's activities were

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85 92 T.C. 1053 (1989).

86 Id. at 1064.

87 Id. at 1064, Taxation with Representation v. United States, 585 F.2d 1219 at 1222 (4th Cir. 1978).

88 Id. at 1070.

89 Id. at 1079.

nonpartisan in nature and that its graduates were not intended to primarily benefit Republicans...."[90]

The most recent case finding excessive private benefit in a political context is The Fund for the Study of Economic Growth and Tax Reform v. Internal Revenue Service.[91] The organization at issue was formed to finance the work of the National Commission for the Study of Economic Growth and Tax Reform, commonly known as the "Kemp Commission." That Commission, created by Senate Majority Leader Bob Dole and Speaker of the House Newt Gingrich, was charged with making recommendations on reforming the tax code. In a brief opinion, the court upheld the IRS' denial of exemption to the Fund on the grounds that it conferred more than an insubstantial benefit on the Republican Party and its candidates. The court also found that it was an "action" organization because its primary objective (determined by the court to be repeal of the Internal Revenue Code) could only be attained through legislation and the organization advocated the attainment of that objective.

The brevity of the court's analysis in the Kemp Commission case stands in contrast with the opinion in American Campaign Academy and, interestingly, the latter case is not even cited in the Kemp Commission case. There seems to be a significant amount of evidence to support the IRS's assertion -- accepted by the court -- that the Commission had a substantial nonexempt purpose of promoting "the advancement of the Republican

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[90] Id.

[91] Civil Action No. 97-0747(RMU) (February 25, 1998), reprinted in 20 Exempt Organization Tax Review 165 (April 1998).

political agenda with regard to tax reform."[92] The court's analysis of why the Fund was an "action" organization is sparse, however, and it is unclear whether the court would have reached the same result had it found the work of the Commission to be nonpartisan.

The relationship of the private benefit doctrine and the campaign intervention prohibition has been largely unexplored. The two doctrines are different in some fundamental respects. The campaign intervention prohibition is absolute, while the private benefit doctrine permits an insubstantial amount of private benefit as long as it is an incidental part of an activity directed to a proper charitable purpose. And while some may cite the CPE Text to argue (wrongly in the author's view) that evidence of a "bad motive" should be irrelevant in applying the campaign intervention prohibition, there is no comparable basis to argue that such evidence would be irrelevant for the private benefit restriction, which is -- at heart -- purpose-based. One commentator has recently observed that the lack of guidance about the interrelationship of these two doctrines has led to "a host of questions."[93]

B. Section 501(c)(4) Organizations

1. Permissible Level of Political Campaign Intervention

Section 501(c)(4) provides exemption for organizations that are "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social

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[92] 20 Exempt Organization Tax Review at 167.

[93] Gregory L. Colvin, "Can a Section 501(c)(3) Organization Have a Political Purpose?" 10 Journal of Taxation of Exempt Organizations 40 (July/August 1998).

welfare . . ." Treasury Regulation section 1.501(c)(4)-1(a)(2)(i) provides that an organization is operated "exclusively" for the promotion of social welfare if it is "primarily engaged" in promoting the "common good and general welfare" of the community and in bringing about "civic betterments and social improvements." Unlike Section 501(c)(3), Section 501(c)(4) does not contain any separate prohibition against political campaign intervention. Treasury Regulation section 1.501(c)(4)-1(a)(2)(ii) makes it clear, however, that the promotion of social welfare does not include direct or indirect participation in a political campaign. This means that an organization may engage in such activities without jeopardizing its exemption under Section 501(c)(4) as long as its "primary" activities are in furtherance of exempt purposes and its political campaign activities do not become primary.

The IRS applied this principle in Revenue Ruling 81-95,[94] which involves an organization that is primarily engaged in activities intended to further its social welfare purposes. The organization also engages in activities that constitute political campaign intervention. The IRS concludes that since the organization's primary activities promote social welfare, its lawful participation in political campaigns would not adversely affect its exempt status. The IRS notes, however, that the organization is subject to tax, under Section 527, on the lesser of its net investment income or its political expenditures.

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[94] 1981-1 C.B. 332.

The IRS takes the position that "whether an organization is 'primarily engaged' in promoting social welfare is a 'facts and circumstances' determination."[95] The IRS has indicated that

> [r]elevant factors include the amount of funds received from and devoted to particular activities; other resources used in conducting such activities, such as buildings and equipment; the time devoted to activities (by volunteers as well as employees); the manner in which the organization's activities are conducted; and the purposes furthered by various activities.[96]

The IRS also takes the position that the definition of "participation in a political campaign" is a "facts and circumstances" determination, and is interpreted the same for purposes of Section 501(c)(4) as for 501(c)(3).[97] Where a Section 501(c)(4) organization engages in "educational" activities in the political arena, the same definitional issues discussed above in the context of Section 501(c)(3) are impacted, although the ability of a Section 501(c)(4) to engage in a significant -- but less than primary -- level of political activities helps to lower the risk associated with ambiguous conduct.[98]

Nevertheless, the exemption issues posed by Section 501(c)(4) organizations that engage in substantial political activities may be quite difficult. The Christian Coalition, a

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[95] Raymond Chick and Amy Henchey, "Political Organizations and IRC 501(c)(4)," Exempt Organizations Continuing Professional Education Technical Instruction Program 191 at 192 (1994) (hereinafter referred to as "1994 CPE Text").

[96] 1994 CPE Text at 192.

[97] 1994 CPE Text at 196.

[98] For an interesting case study of how the IRS interprets Section 501(c)(4) in the context of an organization conducting educational activities in the political arena, see Paul Streckfus, "Empower America: Its Long March to Exemption," 2 Paul Streckfus' EO Tax Journal 21 (December 22, 1997).

nonprofit organization founded by Pat Robertson, is a case in point. The Christian Coalition is reported to have applied to the IRS for exemption under Section 501(c)(4) over eight years ago, and holds itself out as exempt under that provision. The IRS has not granted the exemption, however, and the case apparently remains under consideration at the IRS, presumably in the National Office. The Christian Coalition has offered no public comment as to the reasons for the delay, and the IRS is precluded from commenting on the matter. One possible source of controversy may be the Christian Coalition's voter guides, which have been judged by some commentators to be political in nature and therefore permissible for a Section 501(c)(4) organization (as long as this is not its primary activity) but improper for distribution through churches which are exempt under Section 501(c)(3).[99]

Eight years is a long time to wait for a determination as to tax-exempt status. If the Christian Coalition were seeking exemption under Section 501(c)(3), it would have the ability to force a decision on its claim to exemption. Section 7428 permits organizations seeking exemption under Section 501(c)(3) to file a petition for a declaratory judgment with the Tax Court, the U.S. District Court for the District of Columbia, or the Claims Court if the IRS has not acted on the exemption application within 270 days. There is, however, no comparable remedy for Section 501(c)(4) organizations to obtain some resolution with respect to their claim for exemption, leaving the Christian Coalition -- and

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[99] See discussion at pp. 24 -25, above. See also Fred Stokeld, "Is Christian Coalition Too Political to be Tax-Exempt," 18 Exempt Organization Tax Review 190 (November 1997).

members of the public who continue to be concerned about this matter -- in a state of uncertainty as we approach yet another election cycle.

2. Relationships with Political Action Committees

The ability of a Section 501(c)(4) organization to engage in some level of political activity means that it is permitted to establish and support a PAC. And because Section 501(c)(3) organizations are allowed to have affiliated Section 501(c)(4) organizations to conduct lobbying activities that the charities would not be permitted to conduct directly, it has become common over the past few election cycles for organizations interested in impacting political campaigns to do so through affiliated Section 501(c)(3), 501(c)(4) and 527 organizations.

Several commentators have explained clearly what is entailed in the proper use of affiliated organizations, where there is campaign intervention by the Section 501(c)(4) and/or the Section 527 organization.[100] They have observed, for example, that there must be a clear separation between the 501(c)(3) and 501(c)(4) entities; that the political activities of the 501(c)(4) must be financed exclusively with nondeductible contributions

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[100] See Milton Cerny, "Current Issues Involving Lobbying and Political Activities As They Affect Tax Exempt Organizations," 20 Exempt Organization Tax Review 441 (June 1998); Milton Cerny, "A Primer on How to Avoid the Pitfalls of Electioneering from a Tax Perspective," 14 Exempt Organization Tax Review 23 (July 1996); Milton Cerny and Frances R. Hill, "The Tax Treatment of Political Organizations," Tax Notes (April 29, 1996); Gregory L. Colvin, "An Election Year Guide to Exempt Organization Political Activities," 7 Journal of Taxation of Exempt Organization 74 (September/October 1995).

and not with contributions from the 501(c)(3);[101] and that the activities of the 501(c)(3) must be wholly nonpartisan. Other commentators have also provided a description of the types of relationships that are permissible between and among Sections 501(c)(3), 501(c)(4) and 527 organizations, and have urged the IRS to issue precedential guidance on this issue.[102] The IRS has not done so, and it seems likely that many organizations are not following the principles of separation and nonpartisanship advocated by the commentators.

One commentator has made an interesting study of the role of some exempt organizations as "candidate conduits" in recent elections.[103] Professor Hill has identified several distinct types of conduit arrangements involving one or more types of tax-exempt organizations -- the direct conduit, where the objective is to transfer funds to a candidate committee or political party through an intermediary; the reverse conduit, where the candidate committee or political party transfers or directs contributions of funds to an exempt organization; and a lateral conduit, where one exempt organization makes a transfer to another. Citing examples of the use of each type of arrangement in recent

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[101] It has been suggested that Section 501(c)(3) organizations that have made the lobbying election may make contributions to an affiliated Section 501(c)(4) out of its allowable lobbying expenditure limitation. While this is clearly correct, it does not then follow that the Section 501(c)(4) would be permitted to use such contribution -- which was treated as a lobbying expenditure by the Section 501(c)(3) -- for political campaign intervention purposes, or to support the administrative expenses associated with a PAC.

[102] EO Comments at 865.

[103] Frances R. Hill, "Corporate Philanthropy and Campaign Finance: Exempt Organizations as Corporate-Candidate Conduits," 41 N.Y.L. Sch. L. Rev. 881 (1997).

elections, she observes that such arrangements may allow the parties to circumvent the contributions limits under the FEC rules; to obtain charitable contribution deductions for what are -- in reality -- political expenditures; to mask the identity of the supporter of the matter at issue; and to enhance "the public perception of an issue as legitimate in its own terms and not simply a partisan position."[104]

C. Section 527 Organizations

Section 527 was added to the Code in 1975 into order to codify the administrative position of the IRS -- announced in 1973 but not implemented pending congressional consideration of the issue -- that while political organizations should be entitled to tax exemption on contributions received and expended for political purposes, they should be subject to tax on their investment income and on funds not used for political purposes.[105] In enacting Section 527, Congress recognized that political activity is not a trade or business which is appropriately subject to tax, and that organizations formed to engage in such activity should be recognized as tax-exempt.

1. Definitions Under Section 527

While the principles underlying Section 527 may appear simple, the statute itself sets out a fairly complex scheme for determining what income is exempt and the timing for taxation of amounts that are determined not to be exempt. The following is a brief

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[104] Hill at 932-934. See also Frances R. Hill, "Political Activities of Exempt Organizations," Fifteenth Annual Conference on Representing and Managing Tax Exempt Organizations, Georgetown University Law Center (April 1998).

[105] Rev. Rul. 74-23, 1974-1 C.B. 14, modified and clarified in Rev. Rul. 74-475, 1974-2 C.B. 22.

summary of the key definitions that are relevant to an understanding of the operation of Section 527:

a. Political Organization

> Treasury Regulation section 1.527-2(a)(1) defines a "political organization" as
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> a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures for an exempt function activity . . .

Treasury Regulation section 1.527-2(a) provides that Section 527 organizations must meet both an organizational and an operational test. To meet the organizational test, a political organization must be established for the primary purpose of carrying on an "exempt function." It is not necessary, however, that the political organization be organized as an entity under local law; it may, in fact, simply be a separate bank account established as a "segregated fund." Where the political organization is formed as an entity, the organizational documents must contain an appropriate purposes statement; where the organization has no formal governing documents (for example, where it is simply a bank account), the required statement of purposes may be inferred from "statements of the members of the organization at the time the organization is formed that they intend to operate the organization primarily to carry on one or more exempt functions."[106]

The operational test requires that the organization operate "primarily" for the purpose of carrying out its exempt function. The regulations do not contain any guidance about how to apply the "primarily" test; it is unclear, for example, whether the test is

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[106] Treas. Reg. § 1.527-2(a)(2).

based on expenditures, activities, or both. Examples of activities which are not related to an exempt function, and therefore may not be the primary activities of a political organization, include sponsoring nonpartisan educational workshops, paying an incumbent's office expenses, or carrying out social activities that are not related to the exempt function.[107]

Section 527 organizations are not required to apply for exemption, nor to file IRS Form 990. They must, however, have an employer identification number and, if they have taxable income, they must file IRS Form 1120-POL to report such income. Form 1120-POL does not require the level of disclosure that is required on IRS Form 990. It does not, for example, require disclosure of contributions, presumably because such disclosures are regulated by FEC rules.

b. Exempt Function Income and Expenditures

The term "exempt function" is used, under Section 527, to describe the types of income that may be received by a Section 527 organization tax-free, and the types of expenditures that may be made by the organization without adverse tax consequences. An "exempt function" is defined, under Treasury Regulation section 1.527-2(c)(1), as including

> all activities that are directly related to and support the process of influencing or attempting to influence the selection, nomination, election or appointment of any individual to public office or office in a political organization (the selection process).

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[107] Treas. Reg. § 1.527-2(a)(3)(i) - 1.527-2(a)(3)(iii).

Section 527(c)(3) defines "exempt function income" to include income that is received from certain permitted sources and that is segregated for use only for exempt functions of the organization. The permitted sources of exempt function income include contributions of money or property, membership dues, proceeds from a political fundraising or entertainment event, and proceeds from conducting bingo games.

Treasury Regulation section 1.527-2(c) provides that exempt function expenditures are expenditures that are made to finance exempt function activities. The regulations provide that the issue of whether an expenditure is for an exempt function is a "facts and circumstances" determination, that the selection process does not have to involve an announced candidate or even an individual who ever becomes a candidate, and that an activity occurring between elections may be for an exempt function if the activity is directly related to the selection process in the next applicable political campaign. Treasury Regulation section 1.527-2(c)(2) also provides that indirect expenditures may be for an exempt function. Examples include expenses for overhead, recordkeeping, and solicitation expenses.

Treasury Regulation section 1.527-2(c)(4) provides that the definition of exempt purpose expenditures does not include illegal expenditures -- such as those made in violation of applicable election laws -- even if the expenditures are made in connection with the selection process. Although the regulations do not address the issue of whether the exclusion is for expenditures that are illegal under civil law, criminal law, or both, the administrative position of the IRS apparently is that the exclusion applies only to expenditures that violate criminal law. In the CPE Text, the IRS stated that "[t]he prohibition on

illegal expenditures is intended to apply to criminal activities and not to violations of civil law, regulation, or administrative rule."[108] Some commentators have noted that this interpretation "would appear to be inconsistent with the public policy doctrine which disfavors tax benefits for expenditures relating to illegal activities,"[109] although possibly justifiable based on the determination of the IRS that the tax laws and the election laws are intended to serve different purposes.

2. Taxation of Section 527 Organizations

Section 527(b) provides that political organizations generally are subject to tax at the highest corporate rate (under Section 11(b)) on their "political organization taxable income." Section 527(h) provides a special rule for political organizations which are principal campaign committees (but only for candidates running for Congress); these organizations are taxed at the normal graduated rates rather than at the highest corporate rate.

The calculation of "political organization taxable income" begins with a calculation of gross income. For purposes of Section 527, gross income includes income from all sources that would be taxable under Section 61 (taking into account exclusions thereunder, such as for interest on tax-exempt bonds), other than other than income that is received for exempt function purposes and maintained in a segregated account, and less

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108 CPE Text at 462.

109 Milton Cerny and Frances R. Hill, "Political Organization," 13 Exempt Organization Tax Review 591 at 600 (April 1996). This article contains a thorough and detailed explanation and commentary on Section 527.

expenses that are directly connected with the production of such income. Section 527(c)(2) provides three modifications to this definition; there is a specific deduction of $100; no net operating loss is allowable; and no deductions are allowed under Sections 241 - 249 of the Code. Under these rules, Section 527 essentially subjects political organizations to tax on their net investment income, as well as on amounts that are not expended for the exempt function of the organization.

3. Treatment of Exempt Function Expenses by Section 501(c) Organizations

Section 527(f) governs the tax treatment of political expenditures by categories of exempt organizations other than those exempt under Section 527. This provision applies, for example, to exempt function expenditures made by Section 501(c)(4) organizations. Under Section 527(f)(1), organizations exempt under Section 501(c) that make exempt function expenditures are subject to tax on the lesser of net investment income and the amount of expenditures made for exempt function purposes. Such organizations may minimize their tax liability under Section 527(f) by establishing separate segregated funds to hold funds received for purposes of making exempt function expenditures. Such funds will be treated as separate Section 527 organizations, and will enable a Section 501(c)(4) organization to contain the tax liability on net investment income to that separate organization, without exposing its other investment income to tax.

Treasury Regulation section 1.527-6(b) provides that in the case of "direct expenditures," the definition of exempt function expenses generally will have the same meaning as under Treasury Regulation section 1.527-2(c), described above. This means that Section

501(c) organizations generally will be subject to tax, under Section 527(f), when they engage in the types of direct "selection" expenditures that are exempt from tax if made by a Section 527 organization. There are, however, some two important exceptions. First, under Treasury Regulation section 1.527-6(b)(4), a Section 501(c) organization's expenditure of funds to appear before a legislative body for purposes of influencing the appointment or confirmation of an individual to public office is not treated as an exempt function expense.

The second and more significant exception is contained in Treasury Regulation section 1.527-6(b)(5), which provides that a Section 501(c) organization's expenditure for nonpartisan activities, including nonpartisan voter registration and get-out-the-vote ("GOTV") campaigns are not treated as exempt purpose expenditures. The regulations provide that to be considered nonpartisan, such activities "must not be specifically identified by the organization with any candidate or political party."[110] This exception reflects the fact that both Section 527 organizations and Section 501(c) organizations -- including 501(c)(3)s -- may engage in voter registration and get-out-the-vote activities in furtherance of their exempt purposes.

It would, of course, be inappropriate for Section 501(c)(3) organizations to be taxed on their nonpartisan voter education, registration, and GOTV activities. However, this is an area that offers obvious opportunities for abuses, some of which are alleged to

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[110] Treas. Reg. § 1.527-6(f)(5).

have occurred in the most recent Presidential election cycle.[111] Assume, for example, that a political organization wants to improve voter turn-out in a particular area. Any voter registration and GOTV activities that it conducts must be financed with after-tax donations. If, however, it can find a like-minded Section 501(c)(3) organization to conduct such activities, the political organization may be able to offer prospective donors the opportunity to claim a charitable contribution deduction, potentially reducing the effective cost of the expenditure by up to 45%, depending on the donor's federal and state income tax brackets.

At least for now, the regulations provide for two other significant differences in the definition of an "exempt function expenditure" for organizations exempt under Section 501(c). As discussed above, the definition of an "exempt function expenditure" for Section 527 organizations includes indirect as well as direct expenditures. Examples of indirect expenditures include administrative expenses and solicitation expenses. The FECA allows Section 501(c) organizations -- other than Section 501(c)(3)s -- to make these types of expenditures, and the existing IRS regulations provide that such expenditures will be treated as "exempt function" expenditures only when new regulations are issued which so provide. Treasury Regulation section 1.527-6(b)(2) and (3) notes that these subjects are "reserved" for future action. For the time being, then, Section 501(c)(4) organizations are not subject to tax, under Section 527, on expenditures made for purposes of conducting or supporting a PAC, including the costs of solicitation for the PAC and administra-

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[111] Jill Abramson and Leslie Wayne, "Both Parties Were Assisted by Nonprofit Groups in 1996," N.Y. Times, Oct. 24, 1997 at 1.

tion of the PAC. In addition, the IRS has ruled that a Section 501(c) organization may count, as indirect expenses that are not considered "exempt function" expenditures under Section 527(f)(1), amounts transferred to a PAC that are earmarked to be used by the PAC solely for administrative expenses.[112]

II. Legislative and Administrative Proposals

A. Overview

The federal income tax laws governing the treatment of political activities by tax-exempt organizations are badly in need of reexamination. It has been over a decade since these laws were last reviewed by a committee or subcommittee of Congress. The 1987 review, by the Oversight Subcommittee of the Committee on Ways and Means, culminated in the issuance of a report and recommendations, congressional reaffirmation that "charities should stay out of politics," and the enactment of legislation intended to give new enforcement tools to the IRS to police violations in this area. There is no evidence, however, that the 1987 legislation had any measurable effect; indeed, abuses alleged in recent elections appear to equal or exceed those examined by the Subcommittee in 1987.

While there have been hearings on the subject of campaign finance abuses alleged to have occurred in the 1996 federal elections,[113] legislative proposals for federal campaign finance reform have been stalled. At this writing congressional proponents have

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[112] Priv. Ltr. Rul. 8516001 (Oct. 22, 1984).

[113] See "Final Report of the Investigation of Illegal or Improper Activities in Connection with the 1996 Federal Election Campaign," U.S. Senate Governmental Affairs Comm., S. Rep. No. 105-167 (1998).

been unable to muster enough support to give such legislation any realistic change of passage. And the inability of Congress -- at least to date -- to deal effectively with the need for changes in the federal elections laws suggests that there may be little appetite for any meaningful reexamination of the federal tax laws in this area.

The IRS, for its part, has shown understandable but excessive caution in this area. Although it has proceeded with some enforcement activities during the past decade, there is anecdotal evidence that these audits have been extremely protracted, contentious and accomplished at considerable political cost to the agency. Some exempt organizations have alleged that the IRS has conducted politically-motivated audits, and -- at the agency's own request -- the Joint Committee on Taxation is now conducting a study to determine whether there is any substance to such allegations. And despite repeated requests from the exempt organizations community for more precedential guidance in this area, none has been forthcoming.

Here is the conundrum. Members of Congress are responsible for enacting the laws that govern how they conduct their political campaigns, and the role that tax-exempt organizations may play in that activity. They have declared unequivocally that Section 501(c)(3) organizations should stay out of politics. But they have not declared that candidates, political parties, and political organizations should stay away from Section 501(c)(3) organizations when seeking electoral support. And while members of Congress have charged the IRS with responsibility for providing guidance about, and for enforcing, the laws regulating political activities by tax-exempt organizations, they have done little to hold the IRS accountable for its performance in more than a decade.

What can and should be done? Perhaps the starting point is to recognize that there are inherent, understandable -- and wholly bipartisan -- conflicts of interests that make it difficult for Congress to examine, in a purely neutral fashion, issues that may touch on members' political campaign activities. This includes issues such as whether existing tax laws are adequate, whether such laws have been appropriately communicated to the parties affected by them, and whether they are being reasonably enforced. There are tried and true approaches in the private sector for addressing such potential conflict-of-interest situations, and Congress should consider applying them here as well.

When parties in leadership positions in the private sector are confronted with a situation in which they have a potential conflict of interest, they are rightly expected to recuse themselves and turn consideration of the matter over to others who are not so conflicted. The analogy here is not perfect, because Congress cannot delegate to others the responsibility for enacting legislation and exercising oversight over the executive branch charged with administering it. But it can turn to outside experts for guidance in framing the debate.

What Congress can and should do is to establish a nonpartisan commission of outside experts to examine the issues and to prepare a report and recommendations for any changes that may be needed in the federal tax laws governing political activities by tax-exempt organizations, including the issuance of any precedential guidance that may be appropriate. Such a commission should include representatives of the exempt sector, including religious organizations, as well as representatives from academia, private practitioners and possibly former members of Congress who are knowledgeable about the

realities of campaign finance and the role of tax-exempt organizations in the electoral process. The report and recommendations of such a commission would provide a valuable starting point for congressional consideration. Equally important, it would help to ensure that the relevant issues are considered not in the context of particular abuses that may or may not have occurred in the past, but in the context of what is needed to develop an overall set of laws and administrative interpretations that create consistent incentives for compliance and disincentives for violations, that provide sufficient guidance so that all affected parties fairly may be expected to understand the rules, and that are capable of meaningful and timely enforcement by the IRS.

B. Legislative and Administrative Proposals for Consideration

In the author's view, the creation of a commission tasked to review the federal tax laws on political activities by exempt organizations and to prepare a report and recommendations about any changes that may be appropriate would be the most effective way for the Congress to begin its consideration of these issues. Whether that is done or not, however, it is past time for the tax-writing committees to review the law in this area. It has been rumored for several years now that the Subcommittee on Oversight of the Committee on Ways and Means may be willing to undertake a review of this area. Such hearings would provide a vehicle to begin consideration of the key issues. The following is a list of legislative and regulatory issues that, in the author's view, should be examined as part of any such hearings.

1. Legislative Issues

a. Should the Prohibition on Political Campaign Intervention by Section 501(c)(3) Organizations Remain Absolute?

Any congressional consideration of the laws on political activities by tax-exempt organizations should revisit the question of whether Section 501(c)(3) organizations should continue to be absolutely prohibited from participating in political campaigns, or whether there should be some minimal level of permissible political campaign activity, either just for religious organizations or for all Section 501(c)(3) organizations (that are not private foundations). Some proponents of the latter approach might argue that many charities, particularly religious organizations, already engage in minor amounts of political activity, that it is too difficult for the IRS to police these minor infringements, and that by permitting them to occur, Congress would simply be creating the opportunity for a level playing field with those compliant organizations who take literally the prohibition under Section 501(c)(3).

A danger to this approach, however, is that all public charities would become fundraising opportunities for politicians, political parties, and PACs who would be eager to tap into a new and advantageous source of campaign funding. The problem would be particularly acute for charities that are actively involved in legislative issues. What happens now, outside the charitable arena, is that legislators who have supported legislative initiatives for their constituents often turn to them for help with campaign fundraising. Right now Section 501(c)(3) gives charities a legitimate basis to "just say no" to any such requests. While some charities would welcome, with enthusiasm, an opportunity for

involvement in political campaigns, another -- perhaps even wiser -- view is that many charities would prefer not to be in the position of having to decide which candidates to favor and to which to offend with relatively small amounts of allowable political expenditures.

b. Should Charities be Allowed to Establish PACs?

The question whether charities should be allowed to establish PACs has been raised articulately by at least one commentator, and is an issue that should be addressed as part of any congressional consideration. In the author's view, however, such a change would leave charities in a position similar to what would result if they were permitted to make direct, albeit minimal, expenditures for campaign intervention purposes. Politicians, political parties and PACs would see the new charity-PACs as potential opportunities for fundraising, and charities -- particularly those who are actively involved in the legislative arena -- would face increasing pressure to establish PACs that would make contributions to candidates in order to maintain good relationships for future lobbying activities.

c. Should Candidates, Political Parties and/or PACs be Subject to Excise Tax Penalties on Improper Political Expenditures Made for Their Benefit?

In its 1987 report, the Oversight Subcommittee recommended that consideration be given to imposing a tax penalty on candidates "where the candidate encouraged the prohibited expenditure and knowingly accepted it."[114] It made this recommendation nearly a decade before the Congress imposed excise tax penalties, under Section 4958, on

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[114] Oversight Report at 45.

parties who engage in "excess benefit transactions" with Section 501(c)(3) and (4) organizations. The so-called "intermediate sanctions" legislation also requires the party in violation to pay back the excessive benefit to the exempt organization in order to avoid additional, confiscatory excise taxes.[115]

Congress should consider imposing a similar type of excise tax on candidates, political parties and/or PACs who knowingly encourage and benefit from improper political expenditures by Section 501(c)(3) organizations, and should consider a similar requirement that such parties make restitution to the Section 501(c)(3) for the amount of the improper expenditure. In the author's view, this change would be the single most important action that Congress could take to help enforce the prohibition under Section 501(c)(3). It would align the interests of all parties in making sure that charities comply with the rules under Section 501(c)(3) and thereby would have a significant deterrent effect on campaign-related activities by charities. Indeed, charities who want to act aggressively in political matters might well be deterred more by potential risks to the candidates or political organizations they want to support than by threats to their own exempt status. And candidates, political parties and PACs would have to be mindful of their own risks as well. The messages would then be consistent: charities would be expected to stay out of politics and, for the first time, politicians would be expected to stay away from charities when seeking support for their electoral activities.

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[115] Section 4958(b)(1).

As part of its review of this issue, Congress should also reconsider the efficacy of Section 4955(d)(2), the provision imposing an excise tax on certain types of expenditures made by so-called "candidate-controlled" charities. If the provision is found to be as ineffective as it appears, it should be made more rigorous or repealed altogether.

d. Should PACs Be Allowed to Make Transfers to Section 501(c)(3) Organizations?

Current law allows PACs to make transfers to public charities for activities such as voter registration efforts. In making such transfers, the PAC presumably believes that the public charity's activity, even though nonpartisan in nature in accordance with the requirements under Section 501(c)(3), will have the effect of benefiting the candidate or party served by the PAC. In 1969, Congress enacted Section 4945(f), which imposes special requirements on grants made by private foundations to fund voter registration activities of Section 501(c)(3) organizations. There is no reason that private foundation funding of voter registration activities by Section 501(c)(3) organizations should be more stringently regulated than PAC funding of such activities; if anything, PAC funding should be more tightly restricted. Congress should consider whether requirements similar to Section 4945(f) should be imposed in the case of contributions made by PACs to public charities for voter registration purposes.

e. Should Section 501(c)(4) Organizations Be Permitted to Seek Declaratory Judgments?

While current law allows organizations applying for exemption under Section 501(c)(3) to seek a declaratory judgment if the IRS fails to act on an application for exemption within a reasonable period of time (270 days), there is no comparable provi-

sion for organizations seeking exemption under Section 501(c)(4). Congress should consider whether such organizations should also be permitted to bring a declaratory judgment action to establish whether they are entitled to exemption in cases where the IRS is not able to reach a decision within a reasonable period.

2. Administrative Issues

a. Should the IRS be Directed to Issue New Precedential Guidance under Sections 501(c)(3), 501(c)(4), 4955 and 527?

Congress should examine the adequacy of the precedential guidance that exists under the Code sections governing political activities by tax-exempt organizations. For a number of years, commentators have called on the IRS to issue more precedential guidance in this area, and in the exercise of its oversight responsibility, Congress should determine what impediments exist to the issuance of such guidance. If the statutory authority is lacking, for example, Congress could consider promulgating broad guidelines and delegating regulatory responsibility to the IRS to develop more detailed rules within such guidelines.

The areas that should be examined for possible precedential guidance include issues such as how to determine who is a candidate, what standards apply in determining whether a particular activity constitutes permissible voter education or issue advocacy rather than impermissible campaign intervention, whether or not having a partisan political motive for conducting a particular activity is relevant to a determination as to whether that activity is an impermissible campaign intervention, what are the boundaries of permissible relationships between and among Section 501(c)(3), (4) and 527 organiza-

tions, whether an exempt organization should be subject to tax under Section 527(f) on indirect or other FECA-approved expenditures for a PAC, and whether an expenditure that is determined to be illegal under civil but not criminal law should constitute an exempt function expenditure for a PAC. This is by no means an exhaustive list, but it represents some of the basic issues on which the IRS could reasonably be expected to provide guidance. The recently-issued regulations under Section 4958 (the intermediate sanctions rules), as well as the regulations under Sections 501(h) and 4911 (the lobbying expenditure rules for electing public charities) provide models for the type of guidance that is needed. Both of these regulation projects have provided clear explanations, creative use of safe-harbor guidelines, and detailed examples illustrating the operation of the relevant statutes.

b. Should the IRS Require Greater Disclosure of Information on Form 1120-POL?

The IRS Form 990 is viewed as an important tool of disclosure and accountability for tax-exempt organizations. Congress should review whether IRS Form 1120-POL could be revised to serve a similar function with respect to Section 527 organizations.

c. Should there be Greater Coordination Between the IRS and the FEC With Respect to Political Activities by Exempt Organizations?

In 1987, the Oversight Subcommittee recommended that there be greater coordination between the IRS and the FEC with respect to the exchange of information about political activities of exempt organizations. It noted, for example, that the IRS is not routinely notified of enforcement activities of the Commission that may involve exempt

organizations. The IRS is similarly precluded from sharing its enforcement information with the FEC. Congress should review the statutory and administrative impediments that prevent the coordination and exchange of information between these agencies, and should consider what changes would be needed to allow such coordination.

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The prohibition on participation in political campaigns by Section 501(c)(3) organizations is a subject that is easy to understand in principle but difficult to apply in practice. There are similar complexities in the federal tax treatment of other categories of exempt organizations that are permitted to conduct political campaign activities. While the IRS is often faulted -- and fairly so -- for not taking a more aggressive stance in issuing precedential guidance and vigorously enforcing this area, Congress shares equal responsibility for the uneven state of affairs that confronts exempt organizations as they seek to understand what they may and may not do. It is time for Congress to make a careful and thorough examination of the federal tax laws governing the participation by exempt organizations in political activities, and it would be well-served by seeking the assistance of knowledgeable nonpartisan experts who have a common interest in bringing sound public policy to bear in this important area.

WA05/44084.4